HEARING ON REAUTHORIZATION OF THE SBA AND THE FISCAL YEAR 2001 BUDGET REQUEST

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS HOUSE OF REPRESENTATIVES

ONE HUNDRED SIXTH CONGRESS

SECOND SESSION

WASHINGTON, DC, MARCH 1, 2000

Serial No. 106–45

Printed for the use of the Committee on Small Business

U.S. GOVERNMENT PRINTING OFFICE

71–189 WASHINGTON : 2001

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C O N T E N T S

HEARING ON REAUTHORIZATION OF THE SBA AND THE FISCAL YEAR 2001 BUDGET REQUEST

WEDNESDAY, MARCH 1, 2000

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Committee met, pursuant to notice, at 10:00 a.m., in Room 2360, Rayburn House Office Building, Hon. James M. Talent (chairman of the Committee) presiding.

Chairman TALENT [presiding]. If our first witness will be seated, we will start.

Good morning. Today, the Committee is meeting to conduct its annual ritual of considering the administration's request for the SBA budget. We are also going to consider our triennial ritual of reauthorization of the SBA's programs. I am hoping to save the members a little time while still allowing them full in put by combining the two exercises.

I want to start by saying that, in general, I am pleased with the budget submission for the year 2001, which means that the hearing this year will, as far as I am concerned, have a happier tone than it has had in some years past. I am not necessarily speaking for my friend, the distinguished gentlelady from New York, and I have no inside knowledge in saying that. I am just not necessarily speaking for her.

The SBA's budget request for 2001 is $1.06 billion. This is a large increase over the current year's funding—approximately $330 million. However, to be fair, a large portion of this is disaster loan funding. Thankfully, the 2001 request for the disaster loan program is straightforward and adequate. This relieves us of a serious bone of contention from past years' budgets.

SBA's request for financial programs is also, in my opinion, generally good. It requests $332 million in new subsidy budget authority, a $65 million increase over the 2000 request. Of this request, $132 million is for administrative expenses to operate the financial programs. That represents a small increase over the 2000 request but a significant $38 million increase over previous appropriations.

The request for the 7(a) loan program is $142 million to provide $11.5 billion in overall loans. I believe this is a reasonable request, as SBA forecasting is usually accurate. I am more concerned about this year's loan availability. I will be interested in hearing from the Administrator about her projections for this year.

The 504 Program again requires no subsidy, and I believe the Committee joins me in supporting the authority to make the full authorized amount of loans under this program available. However, like other members, I would like to hear about the future of the program and its subsidy rate.

The SBIC Program also receives an adequate request and one the Committee supported in its letter to the Committee on the budget. If fully funded, the SBIC Program will be able to make over $2 billion of venture capital available to small businesses in Fiscal Year 2001.

The Microloan Program is targeted for the most significant increase for 2001. It would, according to the request, jump from $29 million to $60 million in microloans. While there is no shortage of support for this program, and the real dollar increase is only $2.5 million, there may be some question about the ability to expand that quickly.

On the technical assistance side of the SBA's budget request there is both good and bad news. The good news is the Small Business Development Center Program receives an adequate though not ample request of $85 million. There is also a $3 million request for Native American SBDCs, an excellent proposal.

The bad news is that there is an increase in unauthorized program funding that would take too much time to list here in this opening statement, while at the same time an elimination of funding for authorized programs, like the Drug Free Workplace Program, which the Congress approved overwhelmingly 3 years ago.

Finally, let me state my support for the request for the Office of Inspector General. This Committee has long supported improved funding for that Office. The only comment I might make now is that the increase should be divided between audit and investigative functions.

I want to thank our various witnesses. I will introduce them when they testify. We are going to have two panels: First, Administrator Alvarez, and, second, the panel of witnesses from the small business organizations.

Before we begin hearing the testimony, I will, as always, turn the microphone over to my colleague, Ms. Velazquez, for any statement she may wish to make.

[Mr. Talent's statement may be found in the appendix.]

Ms. VELAZQUEZ. Thank you, Mr. Chairman. I would like to thank the Administrator and commend her for presenting an ambitious budget request that clearly reflects the administration's desire and ongoing efforts to help this Nation's small businesses.

As we are all aware, this country is experiencing one of the greatest economic booms in modern history. This unprecedented growth has been fueled by the flourish of small businesses throughout this country. Today, small businesses make up 51 percent of the gross domestic product, and contribute 47 percent of all sales in this country. In fact, according to the Department of Labor and the Department of Commerce, small business-dominated industries produced an estimated 64 percent of the 2.5 million new jobs created during 1996.

With this in mind, I believe it is critical at this historic juncture to assess where we are, how we got here, and where we need to go to continue to have a strong and vibrant small business community. We have gotten where we are today based on the solid support of such established programs as 7(a), 504, 8(a), microloans, SBR, SBIC, and SBIR. These programs, through access to capital, opening doors for minority businesses and technology development are the bedrock that has helped this Nation's small businesses lead the way into the 21st century.

The administration's budget presents a good mix of new and existing programs. We are making improvements to the SBIR Program through Phase 3 grants that will enable small technology firms to be more competitive in the marketplace. One priority for Democrats has been making small loans more accessible to businesses. This can be done by increasing the guarantee on loans of under $150,000 to 90 percent, offering small businesses the economic chance they need to exist.

Innovative new programs that show consideration for future businesses has been unveiled in this budget, like PRIME, which help low-income communities, and the new Veterans Program, which will help those who have served this country.

Most importantly, the administration attempts to address what I believe is the most pressing issue facing our Nation: The widening gap between those who have prospered from our current economic boom and those that have been left behind. For example, in my district of Brooklyn the unemployment rate is still 10 percent. These are good, hardworking people who today cannot afford to start their own businesses but who want to and deserve an opportunity for economic prosperity.

That is exactly what the proposed new markets venture capital company legislation will do. By providing equity investment and technical assistance, businesses will have an easier time obtaining capital or expanding their businesses in poor or underdeveloped areas throughout the country. This is not only the right thing to do, but it makes good business sense.

This Committee has an opportunity to make changes, new changes that will benefit small businesses and those who are looking for economic opportunity in starting their own. Today's hearing will assist us in making the kinds of economic decisions that not only will help close that widening gap but will hopefully keep us on the right economic track for continued prosperity in the future.

I look forward to reviewing this budget in greater detail and determining what changes need to be made to better enhance small businesses. And I thank you ladies and gentlemen who are here to testify before the Committee today.

Thank you, Mr. Chairman.

[Ms. Velazquez's statement may be found in the appendix.]

Chairman TALENT. I thank the gentlelady.

We will go right to panel one, and our witness in that panel is the Honorable Aida Alvarez, the Administrator of the U.S. Small Business Administration.

Once again, Ms. Alvarez, it is a pleasure to welcome you here.

STATEMENT OF AIDA ALVAREZ, ADMINISTRATOR, U.S. SMALL BUSINESS ADMINISTRATION

Ms. ALVAREZ. Thank you so much, Mr. Chairman, Congresswoman Velazquez, and distinguished members of this Committee. I appreciate the opportunity to appear before you here today, and I have submitted my written testimony for the record. I would like to make some oral remarks accompanied by charts in a moment.

But before getting to next year's budget, Mr. Chairman, I wanted to address your concern about the availability of loan dollars this year, which has been our concern as well. And I would like to share some good news. Last spring, as you know, we requested funding to meet the demand for $10.5 billion in loans for our 7(a) Program; however, our appropriation was only for a level of $9.8 billion in loans. And it turns out that our projections were pretty much on target.

We now project the demand this year to be around $10.3 billion. To address this shortfall, the President has included in his February 25th supplemental appropriation request, $7.6 million for the SBA. Through a combination of transfers and the supplemental appropriation, we will increase the 7(a) Program level to $10.3 billion. Our hope is that the program will continue to operate as successfully as it has through the rest of the year.

The supplemental also will enable us to transfer, and I have requested, $1 million to fund PRIME grants. I know there has been a lot of concern about the funding for the Program for Investment in Microentreprenuers this year. I have also requested a transfer of $0.5 million to support the Veterans Corporation that was included in legislation passed last year. And in addition, we are looking into the possibility of providing free office space this year for the corporation at the SBA. We hope that this will really get them started. We are already halfway through this year, so we think that this might cover their needs. And then of course we have requested $4 million for 2001.

Mr. Chairman, Congresswoman Velazquez, members of the Committee, I urge you to please support the supplemental. And of course I would be happy to meet with you and other members of the Committee to discuss this request and the budget itself.

There is also another bit of good news I would like to share this morning. We were informed late yesterday that for the fourth year in a row SBA has received a clean opinion in our financial audit report, which is the highest rating that a Federal entity can receive. The report, I believe, provides further assurance that we are keeping our financial house in order.

So, now, without further ado, I would like to start the discussion of the budget and our request for just over $1 billion for the SBA with charts that highlight why we are making this request and what is the condition of this economy that makes it appropriate that we request this kind of funding.

We begin with a chart that I think says it all, “It is a small business economy.” Congresswoman Velazquez pointed to the extent to which the new job creation, for example, is attributed to the small businesses in this country. I think that this chart presents the budget in the context of this remarkable economic expansion, an expansion that is being fueled, in large part, by small businesses.

You can see that the numbers just go up, up, up for our core programs, and, as I said, at the SBA I believe we want to keep doing our part to keep this historic economic expansion going, which is why we are submitting this request. And also we want to reach out to those in the inner cities, poor rural areas, Native American reservations who have not been reached yet.

The climate has never been better for small business. There are now 25 million small businesses in the United States, which is 5 million more than in 1990. And our chart reflects this amazing economic expansion. What is interesting is since 1993 we have nearly tripled what is available for small businesses while cutting the cost in half.

In 1993, we made available around $7.4 billion of capital and credit at a cost of $352 million. This year, in Fiscal Year 2000, we estimate we will deliver $17 billion at a cost of $146 million, which is less then half the cost. Our Fiscal Year 2001 budget proposes $20 billion of support at a cost of $200 million. I think this shows that SBA is truly a great deal for the American taxpayers.

Coupled with our desire to sustain the economic expansion while penetrating new markets is our solid commitment to the financial soundness of our portfolio. And I am very pleased to report that in Fiscal Year 1999 we instituted, for the first time ever, a Safety and Soundness Examination Program for the agency's Small Business Lending Companies and examined all 14 Small Business Lending Companies. We expect to complete a second round of reviews in September. We have established the Office of Lender Oversight and a Risk Management Committee. We have completed our first full cycle of reviews for participants in the agency's Preferred Lender Program, and we expect to complete a second round of reviews by April.

Yes, we have enjoyed dramatic growth in our core programs, but speaking to the issues raised by Congresswoman Velazquez, I think we are convinced that it is not enough just to continue their growth. SBA's success in stimulating small business growth is owed to its strategic investments in areas where we have identified a gap. That is what we have historically done. And this second chart illustrates the continuum of services and programs that we provide and where there are still gaps that need to be addressed.

Over time, SBA's programs have evolved to fill gaps in the marketplace. This chart shows the continuum of services that exist today to meet a spectrum of small business needs. On the debt side, SBA first developed the 7(a) and 504 Programs. When the need for very small loans was identified, SBA's Microloan Program was established. On the equity side, Small Business Investment Companies were established to fill the need for investments in the range of $350,000 to $5 million.

Now, as you can see from the lighter shaded area, there is a gap today for small businesses needing smaller equity amounts in the range of $50,000 and up. And filling this gap is what our New Markets Venture Capital proposal is all about.

Our next chart illustrates why that——

Chairman TALENT. Ms. Alvarez, can I just interrupt for a minute? Could you put that last chart up again?

Ms. ALVAREZ. Yes.

Chairman TALENT. Now, I just want to make certain that I understand, because my understanding was the New Markets Program was targeted to—was developed to target additional assistance to low-income areas. You emphasize the size of the loan.

Ms. ALVAREZ. It is an equity investment.

Chairman TALENT. Right, I am sorry. Yes, equity investment.

Ms. ALVAREZ. It is a combination of size and targeting to areas that are underserved, significantly underserved. So, it is geographic and income-based.

Chairman TALENT. Right. So, the President's proposal hasn't changed. It is still for—it is targeted for low-income neighborhoods, but you also are talking about a size of investment.

Ms. ALVAREZ. That is right, because in fact those targeted areas, as the next chart will show you, have a huge absence of availability of equity investments in those geographic areas.

Chairman TALENT. Yes, and that is what I understood, and that was my interest in the program.

Ms. ALVAREZ. You are absolutely right. That is what it is all about.

Chairman TALENT. I am sorry about that; appreciate it.

Ms. ALVAREZ. No, no, that is good.

The following chart shows the incredible differences in availability of equity capital. For example, on the left, you have the bar chart, which shows private venture capital firms in 1999 with assets of nearly $130 billion. Their average investment, the size issue, in both large and small businesses is anywhere from $6 million to $10 million.

In 1999, SBA's Small Business Investment Companies reported assets of $12.7 billion. Their investments typically range from $350,000 to $5 million, with $1.5 million, on average. So, we filled the gap there for smaller size investments through the SBIC Program. What is interesting is that these SBICs with one-tenth of the capital of their larger counterparts were actually responsible for over half the investments by institutional investors last year, which is phenomenal. And this highly successful program has returned $131 million to the U.S. Treasury as taxpayers' share of profits in SBA's Participating Security Program. So, this program is really producing results.

Mr. Chairman, when I said that they produced half of the investments, it is because they make many, many smaller size investments, whereas there are huge investments made by the private venture companies. It is not the dollar amount in this case; it is the number of smaller investments.

On the very right, you see a sliver—it is practically not there—and it shows the assets of the community development venture capital industry. These firms are most like the New Markets Venture Capital Companies that we are proposing. That is where the gap exists. All that is available now—it is a combination of what we are doing with our SBIC Program and these community development venture capital companies.

SBICs invested nearly $800 million in low- and moderate-income areas last year. The fact is that only $66 million of that $800 million were New Market-type investments of $1 million or less. So, what does this mean? It means that out of a universe of around

$140 billion of venture capital in this country, only $200 million was available in smaller New Markets-type investments, which went to areas that include inner cities, poor rural communities, and Native American communities. Again, this is what the New Markets proposal is all about.

The last chart on this topic, which speaks to this geographic issue, is this map of targeted New Markets-type investments. What this map illustrates is where the smaller New Markets-type investments are being made today without the New Markets Venture Capital Program. You can see there is a lot of empty space here. The dots show the locations of community development venture capital companies. There are only 25 located in 16 States and the Virgin Islands. These firms have assets of $157 million, but only 14 of the 25 have assets of over $5 million, which we consider to be the absolute minimum for economic viability. The stars indicate the five states where two-thirds of the smaller New Markets-type investments were made by existing SBICs, Small Business Investment Companies. As the map indicates, even if you combined the $66 million in comparable SBIC investments, which are concentrated in just 5 states, with the SBIC locations, you see that there was no New Markets-type investment, zero, in 21 States. There is a gap, and there is a vacuum that we are trying to fill with this program.

Chairman TALENT. Just make one thing clear for me, and this is very interesting—I am kind of glad you went to the depth on this aspect of the budget submission—when you say the five States in which the SBICs have made New Markets-type investments, you are referring to investments that meet the criteria both in being a low-income neighborhoods and of being the size that you anticipate new markets.

Ms. ALVAREZ. Yes, correct.

Chairman TALENT. Because they have bigger investments than that in low-income neighborhoods——

Ms. ALVAREZ. Correct.

Chairman TALENT [continuing]. But they were bigger size loans.

Ms. ALVAREZ. That is right. They were not the type of investment that we envision for new markets.

Chairman TALENT. Okay.

Ms. ALVAREZ. The SBICs are primarily profit-driven, in contrast to New Market Venture Capital Companies and the Community Development Companies, which are more mission-driven. NMVCs will provide a combination of equity financing and hands-on operational assistance, which we have called technical assistance.

The technical assistance we are talking about is an ownership on the part of the new markets investor which results in their taking an active role in the actual running of the company in areas of corporate finance, structuring, key executive recruitment, legal services. The New Markets Venture Capital companies will have the resources and flexibility to ensure the long-term success of small businesses they invest in.

To establish this New Markets Venture Capital Program we are requesting $21.6 million, which would support a program level of $150 million, and we are requesting $30 million for the technical assistance component.

What I would like to do is take a moment to talk about this program's return on investment. First of all, a number of people have noted that this is an expensive program. Well, it is. It is, initially, because we calculated the cost of this program using the most conservative assumptions. And what we are anticipating is that the cost of the program will go down, probably significantly, as we develop experience with the program.

It is very important, I think, to look at the long-term benefits of this program. We did an analysis of the Community Development Venture Capital Companies where we learned that one job is created for each $10,000 to $15,000 of equity investment. Using this as a basis for comparison, $51.7 million should generate between 13,300 and 20,000 jobs at a cost of between $2,600 and $4,000 each. That is a bargain and does not include the indirect jobs which would make the cost even less.

So, I think that with this modest investment proposed in our budget, we would double the amount of capital available to our distressed rural and urban communities, and we would create a phenomenal potential for jobs in areas like Brooklyn—you mentioned a 10 percent unemployment rate—and other rural parts of the country.

Finally, I want to conclude, with the New Markets Initiative—we are breaking new ground, which is why I took the time to explain it this way. There is another area where we are breaking new ground, and that is in the modernization of the SBA. We are making substantial investment to really make the SBA a cutting edge agency. And I am very enthused about the vision that we have set out in our budget to build a new SBA. It is what I call Project 2003, because 2003 is when we expect to have completed all of this.

As you know, since 1990, our loan portfolio has grown from $17.5 billion to about $50 billion. At the same time, the number of our employees has decreased 22 percent, from 4,000 in Fiscal Year 1990 to about 3,035 right now. And that number will continue to go down. We will have gone down by 146 employees this year.

Project 2003 continues the dramatic transformation. This chart gives you an idea what SBA will look like in the year 2003. We expect to offer our customers online and real-time services. This will allow us to give our customers quicker decisions on their applications and servicing requests. Internally, we will have real-time access to information and sophisticated analysis tools to make better management decisions—services anytime, anywhere. Obviously, SBA's store will now be open 24 hours a day, 7 days a week. Small businesses will be able to file applications from their offices or even their homes.

We will do more paperless transactions with our lending partners, reducing transaction costs. This is especially important for smaller loans that are less profitable for lenders. By this summer, we expect to have the majority of our loan transactions to be conducted electronically. We will have the majority of our lenders basically filing and reporting to us electronically, which will be a real difference in what information is available. We will be able to ask for and collect data that we didn't have in the past or we have had it, but it hasn't been accessible to us. This accessibility will help us with our loan monitoring and risk management as well.

Coupled with our desire to sustain unprecedented growth and to penetrate new markets is our solid commitment to maintaining the financial soundness of our portfolio as well as the security of the business that we conduct online. We are very sensitive to the concerns that are being raised about the security of the information.

Financial statements will be less costly and less time-consuming to produce. Subsidy calculations will be improved in both quality and timeliness.

Mr. Chairman, Ms. Velazquez, members of the Committee, this budget, I believe, is a very sound budget for Fiscal Year 2001. It fully funds the disaster programs and the Small Business Development Centers. It supports expansion of the core programs—7(a), 504, SBIC—increases microloan programs. It does all of this while ensuring the safety and soundness of our growing portfolio and building a modern SBA.

So, I really appreciate the opportunity to appear before you here today, and I will be happy to take your questions. Thank you.

[Ms. Alvarez, statement may be found in the appendix.]

Chairman TALENT. All right, I will ask a few and then defer, because there is a lot of members here, and I understand some of them have to leave. So, let me just ask a couple of mine.

Ms. Alvarez, I appreciate the efforts to support the Veterans Business Development Corporation. I would hope that $500,000 would be a beginning point and that you would be open to more being shifted over.

Ms. ALVAREZ. Of course.

Chairman TALENT. And, you know, my enthusiasm for this is because I think it can work the way I have seen, for example, senior centers work. I mean, I really think this model of using a little Federal seed money to plant these centers in places where then they leverage all these additional private-public dollars and all the activity that the groups that want to participate is very powerful, and I would like to get this going. So, you are not closed to doing more than that if we can get more than that done, are you?

Ms. ALVAREZ. No. We were working within our constraints. Also, Mr. Chairman, you know we are working in conjunction with the Department of Veterans' Affairs, with the Association for Small Business Development Centers, with SCORE. We have entered into agreements with all of them so that we can maximize and not duplicate the efforts.

Chairman TALENT. And what is the status of appointments to the board now?

Ms. ALVAREZ. It is over at the White House, and they are vetting the candidates right now. My understanding is if you have individual requests, they would be happy to engage you individually.

Chairman TALENT. I think what we did was we—by we, I mean the chairman and ranking members of the relevant committees on both sides of the Capitol sent sort of a joint list.

Ms. ALVAREZ. Yes.

Chairman TALENT. Because we are very concerned that this initial group be very savvy veterans' advocates. And I will say for my part—and I think the gentlelady feels the same way, because she and I have talked of this—I am much less concerned about party or political background than I am about just getting strong vet advocates from a wide variety of different places—some from veterans' organizations, some with experience in business—because we have a real chance to draw a lot of private business dollars into this.

I hope you take a moment and make a personal call over to the White House and say, "Let us really concentrate on getting a good group," and I think we have submitted a very good list. So, would you be willing to do that?

Ms. ALVAREZ. Absolutely. And I noted that in fact some of the candidates recommended were recommended by members from both sides of the aisle.

Chairman TALENT. Yes. I know I recommended some—I mean, I really don't care about that. I don't think the Committee does either, but

Ms. ALVAREZ. We have been monitoring it. At this point what they are doing is vetting the candidates, and that is the most time-consuming part to make sure that once they are announced they can get started.

Chairman TALENT. Of course my wife is a veteran, and if the President would be willing to consider her that would be fine. But assuming that that is not going to be the case, I am very interested in that. And let us get that. We all want that to get off on the right foot. I know you do too.

Ms. ALVAREZ. Absolutely.

Chairman TALENT. And your personal attention would be appreciated.

Ms. ALVAREZ. Good.

Chairman TALENT. All right. I have other questions to get into, but I know some members have to leave. So, let me go ahead and recognize the gentlelady from New York.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Ms. Alvarez, why are the subsidy reestimates so high for the 7(a) Program year after year? Doesn't this high reestimate mean the regional subsidy estimate was significantly inaccurate and that program users, both the small businesses and the lenders, are paying fees beyond what is necessary to support the program, and instead are paying fees and income that is simply being used to reduce the Federal debt?

Ms. ALVAREZ. That is a very good question.

Ms. VELAZQUEZ. Yes, I know.

Ms. ALVAREZ. I will ask Greg Walter, as well, to join me on that.

The answer is that we use a very conservative approach to calculating these subsidies. We look at the life of the loan, which is over a 14-year period, so that while one might argue that these loans are performing very well as of recent years, we need to go back to when they were not performing so well. And, so it is those calculations that are factored in that result in a much higher cost which then, of course, results in a reestimate and a returning of funds to the Treasury. That has been the practice of the OMB—it is not this administration; every administration involved in subsidy rate calculations has used this approach as a way of protecting the taxpayer.

Greg, do you want to elaborate?

Mr. WALTER. Good morning. I am Greg Walter, the Deputy CFO. I would like to just add one comment. We believe this is also a very good reflection on the improved performance that we are seeing in the portfolio as a result not only of the economy that allows people to pay their loans back more frequently and incur less defaults but also our improved attention to the portfolio management of the agency. So, we see this as good news, and the bottom line is the cost of the program is only about 1 percent, or $1 for every $100 we loan. This is very great news for small business, we think.

Ms. ALVAREZ. Right. As opposed to—it was $5 10 years ago.

Mr. WALTER. Less than 10.

Ms. ALVAREZ. Right, less than 10 years ago, and it is $1. So, the cost has gone down, notwithstanding the fact that we are using a very conservative calculation.

Ms. VELAZQUEZ. Either the Administrator or Mr. Atkins?

Ms. ALVAREZ. Greg Walter.

Ms. VELAZQUEZ. What has 7(a) defaults averaged for the last 5 years, and what is the default factor in the current year subsidy model?

Mr. WALTER. First, you have to remember that the default history is a long time period. We have a peak and a valley. The peak occurs usually in 3 to 5 years after the loans are disbursed. So, if you look at loans that have been made in the last 5 years, they haven't really fully matured. But the evidence that we are seeing so far is that the performance of those loans is significantly better than the loans that were made in the previous year. And the default history right now is averaging probably in the 8 to 12 percent range. The model that we are using for Fiscal Year 2001 still includes a subsidy default rate of about 14 percent, because it takes into account about a 12- or 13-year historical pattern.

Ms. VELAZQUEZ. Has there been a loan underwriting any change or is OMB requiring SBA to overestimate loan defaults?

Mr. WALTER. The process that we use for estimating defaults is a standard acceptable practice that is used by all the Federal credit agencies. OMB requires us to use a historical analysis as far back as we have information. We like to try to match the time period of the analysis with the average maturity of the portfolios. These loans in 7(a) have a 14-year maturity, so we would like to have 14 years worth of data to do the analysis.

Ms. VELAZQUEZ. So, in essence, what you are telling me is that the 7(a) Program is operating at a profit for the Government under the present structure.

Ms. ALVAREZ. It is helping to reduce the deficit.

Ms. VELAZQUEZ. Ms. Alvarez, I am sure you are aware of the troubling trend that during the nineties the number of procurement center representatives has decreased from 73 in 1993 to 55 now. Of those, half performed this function on a full-time basis. In that same period of time, contract bundling has dramatically increased. We don't have any stronger tool to make sure contract bundling is done fairly than CPRs.

On August 4, 1999, your former associate, Deputy Administrator for Government Contracting and Minority Enterprise Development, admitted here at a hearing that the resources weren't there to handle the problem. In your testimony before the Senate yesterday and in your testimony today, you admitted that contract bundling is a problem. Given that the agency admits there is a problem and in light of all the new spending the agency is proposing, why has this not been addressed in the budget submission?

Ms. ALVAREZ. This is certainly an issue that is brought before us with some regularity. First of all, as the head of an agency, I need to look at the overall needs of the agency and the small business community, and we have made a commitment to fiscal discipline and to continuing to streamline the agency.

And, so when we look at new hires, we try to make those very strategically. We don't want to undermine a critically important program, and we want to be able to introduce some new ones that meet the gaps that we identified in the presentation. Overall, we don't look to increase the number of employees at the SBA, and that certainly affects our ability to hire people in any program, including the contracting program.

I think, also, overall, there has been a change in the way the procurement operates at the level of the Federal Government. Part of the reinvention of Government was streamlining processes. The result has been that the Government is much more efficient and much more economical in how it does its contracting, but there has been a downside. We have fought ferociously on behalf of small businesses to ensure that they continue to receive at this point 23 percent of all the contracts that the Federal Government lets, and we monitor that with great vigilance.

Contract bundling has been a concern. I will ask James Ballentine to talk about new regulations that we think will go a long way to addressing those issues. James, you may want to address that.

I think, Congresswoman Velazquez, with the modernization of the SBA, lots of things are going to be different in a very few years. We are going to be able to free up people from other areas, because we are going to be doing things electronically in a paperless way which will reduce the need for people that we now have in the mix. What that means is hopefully we will be able to rehire new people or retrain in the near future but not until we have completed this modernization. I think it would be premature.

James, would you like to comment?

Ms. VELAZQUEZ. Before he comments, Ms. Alvarez, and with all due respect, we conducted hearings on contract bundling, and Mr. Ballentine was here, weren't you? Were you here?

Ms. ALVAREZ. This was before James became the ADA.

Ms. VELAZQUEZ. And my staff in the Small Business Committee is conducting a review on Federal procurement and contract bundling. And the members on this side aisle, and I am sure on the other side of the aisle, has always been complaining about the problems that small businesses are facing in terms of Federal procurement and contract bundling. And you are telling me today that there are new regulations and that it will be implemented, but if you don't have the people there and the staff to implement those regulations, what good does it make?

Ms. ALVAREZ. Your point is well taken. I hear you.

Ms. VELAZQUEZ. Let me just read this for you: In Oregon and Idaho, in the Pacific Northwest, and the entire upper middle section of the United States—and I have a map here—from Montana to Wisconsin and south to Kansas does not have any PCRs. The State of Hawaii is currently serviced by the one PCR in Arizona who has no travel dollars to Hawaii. Virginia, one of the largest procurement dollar volume States has not PCRs. Would you be willing to commit today to performing a national review for the current PCR allocation and propose a plan that provides for more equitable distribution?

Ms. ALVAREZ. Yes, I will be happy to take a look at that. I think it is a serious situation, and I will be happy to take a look at that.

Ms. VELAZQUEZ. Thank you.

Ms. ALVAREZ. Would you like James to comment at all on the regulations on contract bundling?

Ms. VELAZQUEZ. Sure.

Mr. BALLENTINE. Just to identify myself, I am James Ballentine, Associate Deputy Administrator, Government Contracting Minority Enterprise Development. We have completed the regulations at the agency. They have completed public comment. The closing date was December 27. We received limited comments from the small business community, and we are moving forward with the regulations. We hope to publish the final rule on these regulations by the end of April in hopes of putting in some really good things to control the contract bundling situation.

Ms. VELAZQUEZ. Sure. Will you share those regulations at some point with the members of our Committee?

Mr. BALLENTINE. Be happy to.

Ms. VELAZQUEZ. Sure. Thank you.

Ms. ALVAREZ. Thank you.

Chairman TALENT. I thank the gentlelady and could not agree with her more about bundling. As she knows, we are developing a bill to deal with this, and we sent it over to you last week. And I don't expect you to be able to comment on it now, but I really hope that the agency will get behind us in doing this, because we are not going to—the same situation you have in the executive branch. The other committees of jurisdiction probably fight for their own agency's right, and it doesn't help us a lot to be trying to get some investments in small business and that sort of thing in other areas if at the same time the Government, with its procurement practices, is just withdrawing huge amounts of contracts that small business people would otherwise be able to compete for.

The gentlelady from New York, Ms. Kelly, I understand has no problem with me recognizing Ms. McCarthy, because she has to go. So, I am going to do that, and then what I will do is go back to regular order, and I will correct that by recognizing two on this side.

So, I will go to—Ms. McCarthy is next on the list, and so we will just skip Ms. Kelly and go right to you, because you have to go; is that right?

Well, I know, but—do you have time? If you want, we will just—my understanding was that you needed——

Mrs. MCCARTHY. Fine.

Chairman TALENT. Okay. We will go right to you.

Mrs. MCCARTHY. Thank you. And thank you for your comments. One of the things I had gone over, and I just wanted to ask you if you would clarify it, last year the majority of us here were trying to work with small businesses, especially on a drug-free workplace, and we see that there is no money—there is not funding for this program. Could you explain why or are you fitting into someplace else?

Ms. ALVAREZ. What we have had over a 2-year period is $4 million, which we have been able to let about 30 grants with that amount of money. And, actually, we are in the process now of just getting some preliminary results from those grants. What we were looking to do is see how effective this investment has been before acting. It was premature for us to be asking for additional funding when we really didn't have any practical experience on whether these grants were working or not. That was the rationale behind not asking for the money this year.

Mrs. MCCARTHY. Okay. Just one other thing: On the Women's Business Council, I know that, basically, the committees are going to be asking you to explain why we had budgeted $400,000, and you are asking for $1 million to increase it. Could you explain to us why the increase?

Ms. ALVAREZ. We are also asking for an increase in the number of Women's Business Centers.

Mrs. MCCARTHY. Right.

Ms. ALVAREZ. What we see is tremendous activity with women in business and the need to correspondently respond to that activity. Women have also become involved in the contracting issue as well. Unfortunately, women are receiving less then 3 percent of Federal contracts right now. There is a huge concern, and we have been working very closely with the Women's Business Council and with our own office to expand that.

The Council is currently funded at $600,000 and is seeking an additional $400,000 to expand its economic network, procurement, equity capital and research program. There is really a lack of data and information on women in business, and really they are looking to branch out and be more responsive to what is occurring out there.

Mrs. MCCARTHY. Well, my whole point is I am hoping this Committee will support the increase. I think it extremely important, because working with business women on the Long Island, we know that they are there, and we should be doing everything possible to help them. So, I support the increase, and I am hoping the Committee here will.

Ms. ALVAREZ. Yes, and I think, for example, many states have asked for assistance in setting up their own councils, which is something that we would be doing with this funding. Also, there is an interest in creating a Women's Entrepreneurial Fellows Program. There are a number of areas where we have not had the resources to be responsive, and this program would do that. This budget would do that.

Mrs. MCCARTHY. Thank you.

Ms. ALVAREZ. Thank you.

Chairman TALENT. Okay. I will recognize Ms. Kelly, the gentlelady from New York.

Mrs. KELLY. Thank you, Mr. Chairman.

Ms. Alvarez, there are a couple of things that I was looking at. You spent a lot of your time talking about the $21 million new program and the New Markets Program.

Ms. ALVAREZ. Yes.

Mrs. KELLY. But there is about $950 million that you have asked for in other areas, and I am interested in one particular area, and that is the PRIME Act, which is actually already a law. That is a $15 million program, and I would really like to know what steps have been taken to implement the PRIME Act? What have you done with that?

Ms. ALVAREZ. I am going to ask Charles Tansey to come up here and join me, because he is the principal person implementing PRIME. First of all, we are very enthusiastic about what PRIME can do in conjunction with our microloan program.

Mrs. KELLY. But what have you done?

Ms. ALVAREZ. Charles, do you want to lay out where we are, because we have been working on regulations and setting this up.

Mr. TANSEY. Yes. Charles Tansey. I am the Associate Deputy Administrator for Capital Access. We began work on the PRIME implementation in December. We have convened several meetings of interested parties, with a number of discussions as to how to properly interpret the intent of the bill. We have drafted regulations; we have run it by our General Counsel. They are in circulation within the SBA right now. We expect that they should be going over to OMB shortly.

We hope that we will be able to make awards this year if funds can be made available. It would be essentially a pilot this year and we hope that we can make awards as early as August. That is our intent at this particular point.

Mrs. KELLY. So, you intend to get the awards ready and out here by August?

Mr. TANSEY. Yes.

Mrs. KELLY. Is that what I understand?

Mr. TANSEY. Indeed.

Mrs. KELLY. Will you keep this Committee informed of your actions with that, please?

Mr. TANSEY. Yes, indeed.

Mrs. KELLY. I also wondered when you talked about 23 percent of the Federal contracting dollars going out, I am very interested in how many of those contracting dollars went to women-owned firms?

Ms. ALVAREZ. That is what I was mentioning a little bit earlier. Less than 3 percent did, and we are alarmed by that, although, frankly, we have been working very actively with the women's community, the National Women's Business Council to try to heighten awareness, and also working within the agency structures. I actually have entered into agreements with just about every agency, to develop a strategy targeted at increasing the number of women-owned businesses receiving contracts. So, we are pushing very hard to get that number up. Our goal is 5 percent.

Mrs. KELLY. I recognize that, which is why I asked the question. My question is when you are saying you are working with agencies, are you developing a written plan for them to follow——

Ms. ALVAREZ. Yes, absolutely.

Mrs. KELLY [continuing]. And an awareness plan, so that every procurement office there, including those that are involved with our, for instance, our international people—the embassies and so on—those people all understand that that is where we are trying to go?

Ms. ALVAREZ. I have not only had conversations with them, but I have in writing commitments from them, and we are monitoring their commitments. There is a lot of good will and good intent on the part of the agencies. It is a combination of not only ensuring that it is a top priority for them, which I believe it is, but also women have not been involved in this arena in the past, and developing an awareness and a desire to pursue these contracts is something that we also have to work on the outreach part.

Mrs. KELLY. Well, I think women have been in business for a long time. I started my first business in 1963.

Ms. ALVAREZ. Right, but they haven't been Federal contractors.

Mrs. KELLY. Well, this is true. I also want to ask you, Administrator Alvarez, about the fact that one of the major emphasis that we have in Congress this year and past years has been the Drug-Free Workplace Program, and I see there is no request in this budget. I do not understand your total disregard for the need for us to support drug-free workplace programs. Why is there nothing included here?

Ms. ALVAREZ. We have $4 million. We have awarded 30 grants. They were awarded towards the end of last year. We are in the process now of evaluating the effectiveness of those grants. We really had no basis, at this point, for requesting additional funding, because it was very new, and there was no product, no outcome. We are hoping to see how effective these grants have been in reducing the use of drugs in the workplace and go forward from there.

Mrs. KELLY. When did you award the first drug-free grant?

Ms. ALVAREZ. It was towards the end of last year, September 17th. It was a program that took awhile to get up and running. We were working across agencies, and I wish we had awarded them sooner, but we just couldn't. It was just very difficult to get everybody agreeing on things.

Mrs. KELLY. Can you explain the difference to me between the business information centers, One Stop Capital Shops, and the assistance that is offered by the Small Business Development Centers? I would like to have you further describe how the efforts of these sites can be coordinated. It seems to me we have a lot of different organizations out there that may be overlapping in a way. And I also wonder how many businesses are being served by these agencies?

Ms. ALVAREZ. We have an array of services. In fact, we have an entire department devoted to programs that provide technical assistance, because there are different needs, in some cases specialized, and they require different programmatic responses. Our biggest program, of course, is the Small Business Development Center Program, which is, by and large, based out of universities. The assistance received there by small businesses is in helping them develop business plans, marketing plans. They may involve one or a few sessions, but it is not an ongoing involvement.

We also have SCORE volunteers, retired executives, who operate out of various locations—sometimes out of the Small Business Development Centers, One Stop Capital Shops, et cetera.

One Stop Capital Shops are located in Empowerment Zones, which is not where the Small Business Development Centers are located. And One Stop Capital Shops, as the name implies, is a coordination of different agencies, local government, and community organizations, all located in one place to be of assistance to small businesses in those communities. We have within each One Stop center a Business Information Center.

A Business Information Center is a collaboration between the private sector and SBA. The private sector normally provides hardware and software packages and assistance in setting it up. We work within the community and find the space and maybe research assistance. The business person will come in, and we will direct them to this library, if you will, and we will even train them on how to use the software packages so that they can develop their business plans. We have USEACs, which is our U.S. export assistance centers. Again, that is a coordination and collaboration across agencies, SBA, Commerce Department, and Ex-Im Bank for the purpose of encouraging small businesses and supporting them in their pursuit of exporting transactions.

We have Women's Business Centers that provide specialized support to women who often have specific circumstances in their lives that are different from other business people. Some of them specialize in helping women who are coming off of public assistance and welfare. Some of them specialize in helping women access venture capital where there is a huge lack of venture capital available to women in business.

I actually have a chart here that goes through each one of our assistance programs and outlines how it is that we help small businesses in a particular way.

Mrs. KELLY. Are these centers linked? Because we really want to make them linked—make sure that they are linked, because the more assistance, the better. And do your district offices administer all these programs and oversee all these programs?

Ms. ALVAREZ. Our district offices, for example, with the Small Business Development—

Chairman TALENT. If you would yield just for a second?

Ms. ALVAREZ. Yes, sir.

Chairman TALENT. Maybe the gentlelady can make this the last one, and then we come back later if you have more.

Mrs. KELLY. Yes.

Chairman TALENT. Okay. Go ahead.

Ms. ALVAREZ. And I would be pleased to meet with you and talk with you in detail about this.

We have online Women Business Centers; we have SCORE counselors online across the country, obviously, providing advice and expertise wherever they are needed. I wish we could link the Small Business Development Centers, but by law, they are meant to stay within their states. I have repeatedly said I would like to see all these SBDCs linked across the country so that if one has a particular expertise, it could be accessed by someone in a different state, but apparently that is not possible right now.

Mrs. KELLY. Thank you very much.

I have run out of time. I do have more questions, but I, unfortunately, am one of those people who has to leave, so I hope you will hold the record open so I can submit those questions in writing.

Chairman TALENT. Sure. Well, let us do that right now, as a matter of fact. Without objection, we will hold the record open for 10 days.

And, also, I meant to mention, Ms. Alvarez, I would like to—I didn't see some of your statements regarding the NMI in your written testimony, so I would like to be certain that you include and copies of those exhibits also for the record.

Ms. ALVAREZ. Yes, sir.

Chairman TALENT. I thank the gentlelady. Her lines of questioning was very good. I didn't interrupt for that reason but only because we have other members.

Now, we are going to go in this order, which is the order in which people came: Mr. Pascrell, Mr. Phelps, Ms. Christian-Christensen, Mr. Hinojosa, Mr. Davis, Ms. Napolitano, Ms. Tubb Jones, and Mr. Baird.

Mr. Pascrell?

Mr. PASCRELL. Thank you, Mr. Chairman. Good morning, Administrator; good to see you again.

Six contracts worth $3.7 million were awarded as a result of the HUBZone preferences in Fiscal Year 1999. Based on the numbers that I have, figures that I have seen, this works out to be 0.002 percent of the Fiscal Year 1999 dollars rather than the goal that we had established at 1 percent. If we are spending $2 million on the program and there is only 3.7 in contracts to show for it, to me, this does not seem like a very good return.

I would ask you to look very carefully at that, because I believe that the Federal contract preferences which were associated with the HUBZone approval is a critical program, and it can work out very nicely. And if there are difficulties in implementing it, we want to know about it, not before the horse is too far out of the barn and down the road.

Coupled to that is something I want to bring to your attention. We had a Small Business Subcommittee field hearing in my district not too long ago, and the HUBZone was one of the targets, one of the focuses. We came up with this kind of a situation, and I think it is pretty common: Some businesses can take advantage of this program, but they are actually and physically across the street from the zip code and the district which enables them not—which would enable them to be part of the HUBZone district. I think that this has to be reviewed, and we need to be a little bit more flexible in who is eligible and who is not eligible. Because what this does frequently is pit one town against another town, and I think that that, in the long run, will have a negative effect in terms of what we want to do. Have you heard about this, and what do you think?

Ms. ALVAREZ. I think HUBZone has the potential to be a terrific program, and I am pleased with the results we are seeing already. Anytime you start a brand new program with limited resources, it takes awhile to get it set up and also to get the word out. Outreach is a key part of any new program. And we started out with very limited resources, two employees.

One of the things that we did do that took time was we decided that we wanted to create a new program that would be consistent with a modernized SBA. The only government contracting program right now where we can do everything electronically is the HUBZone Program—everything from identifying your eligibility to applying. It is the model, and we intend to integrate the other contracting programs into that model so that in the future, whether it is 8a or SDB it is going to be a simplified application on line. That took 6 months to do in the first year of a program. That is not by way of apology, but it is by way of explanation.

We had $2 million, which is not a lot. We are asking for $5 million. We need to hire more people. We need to do more outreach. In the process, again, as with any program, we have discovered that we need more flexibility; you are absolutely right. And, so we have been rewriting our regulations and revising them so that we can let more folks into this program, because in the end it is going to be really a terrific program. It is geographic and income-based, and it is going to create jobs.

Mr. PASCRELL. How soon can we see some changes and results of that flexibility within this program?

Ms. ALVAREZ. James, do you want to comment on where we are with the revised regs?

Mr. BALLENTINE. Yes, Congressman, we intend to publish the revised regs at the end of April. We anticipate the revised regs being final in July of this year.

Mr. PASCRELL. And just one final question, Mr. Chair.

What can we look for—I mean, give me some parameters in the example that I used, for instance. I think it is a good example; this is happening all over the place. How do we bring that community across the street, in another zone, in another zip code to make it eligible?

Mr. BALLENTINE. The revised regs will not address that issue. The HUBZone Program is designed by census tracks. The census tracks are, of course, based upon the low income housing tax credit program administered by the Department of Housing and Urban Development. We would have to really revise the program and refocus the program if you are going to change these census tracks. And that would be something that we would have to work with the Department of Housing and Urban Development to do.

Mr. PASCRELL. Then you are not answering my question, really. If we are going to continue to use the same basis, the same demographics, the same census tracks, or enumeration districts, whatever, we are going to come out with the same conclusion.

Ms. ALVAREZ. I think the key here, Congressman, is that HUBZones were designed so that the principal place of business for a company would be located in the HUBZone, because the intent was that they would hire 35 percent of the employees from the HUBZone, and they would generate economic activity in the HUBZone. That is why it is hard to have flexibility around the area of where the company is located. If the company wants to relocate its principal place of business, they can do so. We can have some flexibility. But otherwise we run the risk of companies who are not in the HUBZone wanting to conduct business away from the area where we desire to create jobs.

Mr. PASCRELL. That is absolutely unsatisfactory, that response. So, what you are telling me is that you don't intend to change the definition of a HUBZone.

Ms. ALVAREZ. We will be happy to pursue it.

Mr. PASCRELL. Excuse me, if I may. What I am talking about is where you have a HUBZone on one side the street—I remember the discussion and how this got started. And on the other side of the street, which may happen to be a suburban community, which hires many of the very people that live in the communities and urban areas that we are trying to help—I live in one of those areas. But it seems to me that we are punishing the business simply because it physically is not inside that HUBZone. That, to me, divides communities and has a philosophical negative impact upon what we are attempting to do. In the long run, we accomplish nothing. We are supposed to be bridge builders.

Ms. ALVAREZ. The purpose of the program is to create not only jobs but an infrastructure in communities that may be across the street from a suburb, but the moment you physically locate a business in an underserved community, you create the need for other businesses to serve that business. You are right, there is a philosophical difference. The point of the program was that companies would be locating in places where they might not ordinarily locate, hiring people from those communities in their neighborhoods. That was really the intent of the program.

Mr. PASCRELL. You can't expect a business, simply because it lives just out of the zone, to up and relocate physically, if they could, into the HUBZone. I am talking, more important than the example I gave, philosophically, that isn't reality. And I tell you this from experience, being a mayor, being a State legislator, we ought to be working with each other.

And this divides communities. It is like what we have in New Jersey—enterprise zones. The enterprise zone stops at Main Street. On the other side of the street is another town as if it is a foreign country, and it is not. Believe me it is not.

Thank you.

Ms. ALVAREZ. Thank you.

Chairman TALENT. I thank the gentleman, and I think the message perhaps for the Administrator, not to speak for the other members, is that there are some concerns we have. I mean, I mentioned the Veterans Program, and I appreciate your response there. And Ms. Velazquez talked about procurement assistance, and Mr. Pascrell has talked about HUBZones. And this is a cooperative effort. I mean, I understand that you have your priorities, and most of them I think I agree with, but we certainly want attention paid to——

Ms. ALVAREZ. I would be very happy to pursue this. I am trying to set out what the thinking was behind the HUBZone Program, and we are being flexible, which is why we have new regs that are being proposed. This is one area that is not included in that reg process, but we can look at it and try to be as flexible as we can. I appreciate that.

Chairman TALENT. Yes, if there are changes that are needed in the statute for something——

Ms. ALVAREZ. Yes. Maybe there are changes needed in the statute, because I think——

Chairman TALENT. That would be very helpful.

Ms. ALVAREZ [continuing]. It goes beyond the regulatory process.

Chairman TALENT. It is very helpful with you having grappled with it on a hands-on basis, to say, "Look, we have tried to do this, and we can't. Now we need this." And that makes it much easier for us rather than trying to anticipate. Because I would rather not have to go to the statute if you have the regulatory authority.

Ms. Christian-Christensen is next.

Ms. CHRISTIAN-CHRISTENSEN. Thank you, Mr. Chairman.

Good morning.

Ms. ALVAREZ. How are you?

Ms. CHRISTIAN-CHRISTENSEN. Fine. I wanted to congratulate you on your audit report and——

Ms. ALVAREZ. Thank you.

Ms. CHRISTIAN-CHRISTENSEN [continuing]. All of the other successes that you have outlined for us this morning. And thank you, of course, for the support that you have given to my district in many of the areas that you discussed.

We are also very interested in the New Markets Initiative.

Ms. ALVAREZ. It looks good, doesn't it? I like it. I like it. We need to get a camera. Sorry.

Ms. CHRISTIAN-CHRISTENSEN. That is okay. No, we like it too.

We are very interested in the New Market Initiative also, and as you reach out to the Native American and the other rural areas, we hope that the territories will also be given some special consideration.

I have maybe two questions. One is about farming, and the Committee has had several hearings on agricultural issues. The most recent was regarding saving the family farm. The Fiscal Year 2001 budget submission has a component that addresses Native American-owned business technical assistance, and the Fiscal Year 2000 submission had a component that addressed veteran-owned businesses. Is the SBA looking at each one its technical assistance programs to see what kind of assistance can be provided to farmers?

Ms. ALVAREZ. Yes, we are. And Charles may want to speak to the fact. We have been involved in rural roundtables, looking at all our programs to see how we can adjust and be responsive to the needs of the rural communities. We also think, for example, the New Markets Program will be terrific for rural communities where there is really a lack of access to equity.

So, Charles, I don't know if you want to add something, but we are actively pursuing a rural strategy at the SBA.

Ms. CHRISTIAN-CHRISTENSEN. Yes. And maybe in the comment they might want to comment on a memorandum of understanding that will allow USDA lenders to participate in the 7(a) Loan Program that is being proposed?

Mr. TANSEY. Yes. Charles Tansey, ADA Capital Access. We are pursuing a memorandum of understanding with the USDA. The idea was to try to build momentum back into rural areas of the country. We have seen a distressing trend away from the use of some of the SBA programs, particularly in states with large, rural areas, and we want to find a way to rectify that. We have determined an effective strategy would be to work hand-in-hand with the USDA, particularly with their intermediary lending partners, or lenders, who are already out in rural areas where either our lending partners don't have a presence or our districts don't have presence. They could use the 7(a) Program in particular to augment their limited resources. That is the first piece of it.

There are a whole series of other things that we are looking at, and we are trying to make adjustments for our program so that we can build momentum in the rural areas. I think that is a general outline. Every month we are having a rural roundtable in various parts of the country to hear what people have to say about what needs to be done and how we can work with other agencies in addition to USDA. We will have a report on that sometime in June or July.

Ms. CHRISTIAN-CHRISTENSEN. Thank you for that answer.

We have several members on our Rural Business Enterprise Subcommittee that might be interested in having some of those roundtables held in their districts, and we will share that with you.

Ms. ALVAREZ. We would be happy to pursue that.

Ms. CHRISTIAN-CHRISTENSEN. Thank you. And I have a question also about the small, disadvantaged business. That is something that I am very concerned about. And as of 10–1–99 if a firm is not SBD certified, it won't be recognized as a minority-owned business by the Federal Government as far as procurement. And if they are not certified, also the large prime contractor won't get credit for using the SBD as a supplier to meet its goals.

The application seems very complex, and I would be interested in hearing what is being done to make this application process easier?

Ms. ALVAREZ. I agree. We are simplifying the application. We are actually looking to combine the 8(a) and SBD application and ultimately do it electronically.

James I don't know if you want to comment further on that process.

Mr. BALLENTINE. We do indeed intend to simplify the application. We agree with you, as well, that it is a complicated application, and to some extent the 8(a) application is also very complicated. As the Administrator mentioned, we are planning to streamline that. We, in fact, hope to have that totally completed, cleared through the Office of Management and Budget by the end of this month.

Ms. CHRISTIAN-CHRISTENSEN. Thanks. Let me give my colleagues an opportunity to ask some questions. Thank you very much.

Ms. ALVAREZ. Thank you, Congresswoman.

Ms. VELAZQUEZ [presiding]. Yes, Mr. Hinojosa.

Mr. HINOJOSA. Thank you, Madam Chairman.

I am very pleased to be able to listen to the presentation that you made as to how you anticipate SBA will look in the year 2003. We look forward to helping you get there, and that it will indeed be easier to create those New Market Initiatives that you talked about and access the capital for all women and minorities to get into business or expand their businesses. In this New Market Initiative, I know that there are some regulations that are supposed to be published. When will they be out?

Ms. ALVAREZ. Well, first, we need authorizing legislation. We have a proposal from the Senate side, and we are hoping to have one from the House side shortly.

Mr. HINOJOSA. Do we have one?

Ms. ALVAREZ. We do have appropriations, but we don't have the necessary legislation.

Mr. HINOJOSA. Well, has anybody in the House of Representatives initiated that?

Ms. ALVAREZ. We have been working very closely with Congresswoman Velazquez to ensure that we will have some legislation on the House side. She might want to comment on it.

Ms. VELAZQUEZ. There is going to be a meeting between the staff of SBA and my staff. Once we finalize the changes that have been made, it will be introduced probably next week.

Mr. HINOJOSA. Excellent. Those of us who have empowerment zones, especially rural empowerment zones, are desperately waiting for that to get started, and if you need authorization, Madam Chair, I want to be sure that you know that I want to be part of that. I want to help, both in being a co-sponsor and being on the House floor to speak in favor of it.

Ms. ALVAREZ. Very good.

Mr. HINOJOSA. You and I also had a discussion at the end of last year regarding efforts by some associations who were trying to change the definition of a small business to be less 50 percent. And I just want you to bring me up to date. Has it been cleared that we are going to stay with the 51 percent, as I know I am in favor of?

Ms. ALVAREZ. Yes. The National Minority Suppliers Development Council was exploring redefining what constitutes a small business from the standpoint not only of ownership but of control. I think their intention was to make as much equity capital financing available to those businesses as possible.

We are very supportive of having more venture equity capital available for minority-owned businesses, but we were very clear that the law defines minority ownership as 51 percent ownership and that we will continue to support that. It is the applicable law with respect to all Federal programs, and we believe that it is a way of building minority businesses by ensuring that there is 51 percent minority ownership and that there is no misrepresentation of who really owns the company.

We have been on the record. I believe that the council did go ahead and pass a resolution.

Ms. VELAZQUEZ. At the end of January they changed.

Ms. ALVAREZ. Yes.

Ms. VELAZQUEZ. From 51 percent.

Ms. ALVAREZ. But that does not affect the law, and it doesn't affect our interpretation of the law. My concern was that there shouldn't be confusion out there. A private entity redefining what constitutes a minority-owned business has no applicability to our definition of what constitutes a minority-owned business. Fifty-one percent ownership is the law.

Mr. HINOJOSA. I certainly support the law, and I think that there are exemplary programs out there where large corporations, like Burlington Factories, have gone in and found medium-sized businesses and done limited liability partnerships where they buy 49 percent equity in that company and thus accomplish exactly what the other group was trying to do by saying we needed to have it at less than 51 percent. And there are still other large companies, like ConAgra, that are again using that limited liability partnership example and doing it successfully with only 49 percent.

So, I think that we need to just take those exemplary programs, highlight them throughout the country so that those medium size or small businesses can pursue moving to expand their facilities into some of the empowerment zones and help us create jobs in those places that just need so much help.

Lastly, there was another one here that—on e-commerce, it seems that when you were meeting with the folks over at the U.S. Senate, in your testimony you said that $5 million of your budget is to expand training, offering classes on topics like building a web site, conducting e-commerce on the Internet, marketing your business online, and on and on. But according to the staff, they feel that with the way this is going that the money is dedicated for other items. What are they?

Ms. ALVAREZ. I don't know what they would be. We had a very successful Y2K initiative at the SBA where we conducted hundreds of seminars and forums around the country. We estimate that about a million small businesses came to seminars, summits, conferences that were focused on technology. And my first reaction was let us keep the momentum going, because it is clear that there are thousands, millions of small businesses out there who recognize that they have to use technology to be competitive.

Part of the proposal would cover e-commerce summits around the country, a high level of visibility for the role of e-commerce and technology in small businesses. We are only beginning to scratch the surface on what we can do with online classrooms and other online activities. We know that government contracting is going to be conducted online more and more. And, so we need to make an investment that involves people and resources and activity to get our small businesses prepared.

Mr. HINOJOSA. So, do you have the staff now that can go and help us conduct an e-commerce summit in our region?

Ms. ALVAREZ. What we did was we took regional and local staff, combined it with experts from central office, and we pulled together the summit, and if you are interested, we would do that.

Mr. HINOJOSA. Yes, I am.

Ms. ALVAREZ. Yes.

Mr. HINOJOSA. Thank you.

Thank you, Madam Chair.

Ms. VELAZQUEZ. Thank you.

Mr. Davis.

Mr. DAVIS. Thank you very much for your testimony and your responses to the questions that have been raised.

Let me just begin by first of all commending and congratulating your agency for the very aggressive work that it has done throughout the country especially as you have promoted the New Markets Initiative and especially as you have responded to questions and concerns that we have raised about contract bundling. And let me just say I appreciate the fact that there are going to be new regulations coming soon, although I may as well just state for the record that as far as I am concerned looking for contract bundling to assist in the development of small businesses is like looking for light in a dark place.

And I appreciate the fact that your agency has tried to squeeze out some regs that might in some way prevent the further harm that contract bundling can do for small business development, but I think that you have been at a terrible disadvantage in trying to implement that legislation and make it consistent with the goals and objectives of the Small Business Administration. So, I just want to say that——

Ms. ALVAREZ. Thank you.

Mr. DAVIS [continuing]. I appreciate the—the other concern I have is with the New Markets Initiative. In the county in which I live, Cook County, Illinois, which is the second largest county in the country, 5.1 million people in our county, and in that county only 14 percent of all loans that have been made in Cook County have gone to low-income areas. And there are a lot of low-income areas. As a matter of fact, in my district alone, I have over 165,000 people who live at or below the level of poverty.

And, so my question is that even with the proposed New Markets Initiative—and I also know that many of the SBA programs have been aggressively marketed, that people have in fact attempted to make use of them. You have got some good staff out there. But in spite of all that, when you look at the bottom line, the real deal is that the resources are not getting to the people who need them. The help is not getting to the people, in many instances, nor the communities that really need it. Do you think that the request in the New Markets Initiative is really enough or I am saying, should we get things moving, will this be enough to really make a significance difference or impact throughout the country?

Ms. ALVAREZ. Thank you very much, Congressman. I think that is a very thoughtful question. And the presentation I made on the New Markets Venture Capital Program only highlighted a program which is new and requires legislation, and therefore I went to some length to explain what that was about. We actually have a much bigger strategy to address precisely the concerns that you have raised.

On the loan side, on the debt side, and on the technical assistance side we have focused on smaller size loans, because that is where the greatest need is in communities that are underserved. And to address that we have asked to double the size of the Microloan Program. It is the reason we are very supportive of PRIME, which will help microenterprises and the microlenders to really serve those communities.

We have also asked for an increase in the guarantee for small size loans. The reason is that we have seen a significant drop in activity by our regular lenders in the smaller size loan area. When we introduced LowDoc we had a phenomenal success with it. It had a 90 percent guarantee attached to it. The moment we changed that guarantee to 80 percent, we started to see the numbers fall off, and we started to see many of the smaller lenders get out of the program.

So, in response to the criticism and the concerns we have gotten from the lending community, we are proposing a 90 percent guarantee for smaller size loans. We hope that that will encourage more activity on the loan side. That needs to be accompanied by equity investments. A company that would receive an equity investment through the New Markets Venture Capital Program would be a growth company, and so they would be much further along, for example, than a microborrower. Still, they would operate in precisely those communities, and that kind of an investment of capital would create jobs in those communities.

And that also gets further, I think, enhanced through the HUBZone Program. The idea behind the HUBZone Program was, again, locating businesses in geographically distressed communities to create employment for folks in those communities as well as an infrastructure. So, I think we have really a three-pronged strategy for New Markets that cuts across lending and technical assistance, equity investments, and contracting. We are looking at the smaller businesses, because that is where we think that there is a lack of capital, credit, and presence.

Mr. DAVIS. Thank you very much.

And, Mr. Chairman, I also want to commend both you and the ranking member for looking at these issues legislatively, because I think that in many instances we have given the Small Business Administration mandates, but at the same time they have had some handcuffs on. We have said, “Go out and do this, but you have got to do it in compliance with the laws, the rules, and regulations that are established legislatively.”

And as one who has been interacting with the Small Business Administration in low- and moderate-income communities for about 30 years now, I am convinced that in many instances what we have done is we have set up programs, mandates, but in many instances the restrictions were so tight that individuals couldn’t reach the goals that we had set for them. And I am just pleased to know that there is a level of awareness that have us trying to address legislatively some of the impediments to the implementation of the Small Business Administration mandate. So, I thank you very much.

Ms. VELAZQUEZ. Thank you, sir.

Chairman TALENT [presiding]. The gentleman always makes a very good point, and this is a—there is a kind of a creative tension that works here. And what I would just encourage the Administrator to do is where she feels she needs additional flexibility to meet our time limits to be aggressive in letting us know that so that we can work with her.

And conceding full marks for the difficulty of these things, we still need to have them done. I think the point Mr. Pascrell made about the HUBZones, the regulations should not have taken as long as they have taken to produce. And if there is problems, we need to work with them and get them done. And I don’t understand the Administrator to be saying anything different than that. One of the reasons we have these hearings and why I appreciate the members’ participation is to flag for the Administrator areas where we are concerned——

Ms. ALVAREZ. Yes; appreciate that.

Chairman TALENT [continuing]. And make sure that—because she is very busy, and make sure that we impress upon her in a forum which can't be ignored, frankly, our intention to make sure that these things are done.

Ms. Napolitano, I appreciate your patience.

Ms. NAPOLITANO. Thank you, Mr. Chair, and with this patience I learn, because I listen more than I can speak.

Thank you very much, and I echo the sentiments of my colleagues about what I believe to be one of the best working committees to address the issue that affects us at the local level. One of the areas that really concerns me, Ms. Alvarez is the Welfare to Work, and you had a request in 2000 of $761,000, and you are requesting a lesser amount than last year, a decrease of $193,000. With the enactment of the Personal Responsibility and Work Opportunity Reconciliation Act in 1996, along with the President's Welfare to Work Initiative, it effectively ended the current welfare system as we all knew and loved it.

The SBA is participating in this initiative by providing training to individuals leaving public assistance, providing technical assistance to welfare recipients who have potential to become entrepreneurs, and we have discussed this at length, and educating small business owners on the Welfare to Work Program in order to obtain hiring pledges from them, which is in my area the Private Industry Council that has been doing that for a long time, and now we are asking them to do other things, including, of course, look at the Welfare to Work Program.

You state in your budget you have exceeded your three-year goal for the business commitments to hire individuals participating in this initiative. What kind of follow-up is conducted with the small business community to determine if those commitments are honored and to determine if there are ways to improve the SBA's efforts, realizing that specifically in California it really hasn't begun to hit the cap? In other words, there was a limit. That limit is just barely becoming a reality. How do we know that we won't be able to need more assistance to help small business be able to take in those Welfare to Work recipients and the training that goes along with it?

Ms. ALVAREZ. The Welfare to Work Initiative is a very important one that took very seriously. And I am happy to report that we really accomplished quite a bit, which is why, at this point, we don't think we need additional funding.

For example, we set three-year concrete numerical goals which we actually exceeded. We had wanted to achieve at least 200,000 commitments which meant—commitments that small businesses would either step up to the plate and commit to hiring someone from the public assistance rolls or we could assist an individual in becoming an entrepreneur. We actually exceeded that goal.

Sixty-seven percent was business commitments to hire, and 33 percent was providing entrepreneurial training. We are pleased to say that we reached 210,029 total commitments.

We produced and distributed a Welfare to Work tool kit for small business owners. Small businesses told us that they had a shortage of workers, and we said here is an opportunity for us to connect the small businesses with the potential workers. That is why the

Welfare to Work tool kit was important, because we needed to educate them.

We launched a public service campaign which got out the word. We entered into formal partnerships with government agencies, trade associations, not-for-profit organizations so that we could expand the scope of what we were doing. And we certainly worked with the private industry councils. Every single district office entered into a different kind of relationship with the PICs.

We also built a world-class Welfare to Work web site that contained the tool kit, the pledge cards, the success stories, and our award winners. That site averages 8,000 hits a week.

We feel we did what we set out to do, and we are continuing to leverage our resources. We felt at this point in time we were not looking for programmatic increases, and we were just looking to keep pace with what we have done.

But it is an important challenge, and we don't want to be asleep at the switch. I don't think we are, because I think we have at the field level internalized these objectives. They are holding events, outreach and acting on Welfare to Work goals really as part of their day-to-day business, which is what we wanted.

Ms. NAPOLITANO. Okay. So, you don't think there is going to be a demand or as high a demand possibly due to the economic viability.

Ms. ALVAREZ. I think that the economy is so strong and people are so eager to find workers and, that is what the New Markets Initiative is all about. It is about finding another way to give people employment and entrepreneurial opportunities, because we don't want people overlooked because structurally things haven't been set up to address those areas. The New Markets Initiative will help a lot of folks who still fall within the Welfare to Work category.

Ms. NAPOLITANO. Now, you do work with Labor on that issue?

Ms. ALVAREZ. Yes, absolutely. I have had many conversations with Secretary Herman, and we have formal relations with them about this topic.

Ms. NAPOLITANO. Thank you.

The other question, of course, has to do with the Drug-Free Workplace grants, and unfortunately we don't hear the issue of drug in the business being lessened. We seem to have a tremendous problem in the United States. What can you tell us about how the program has worked? What success have you had with it, and also what performance measures have been used to evaluate the success of your Drug-Free Workplace Program?

Ms. ALVAREZ. First of all, we think it is a good objective, and we are very supportive of it. It is really too soon for us to evaluate the outcome of the program, because, as I had mentioned earlier, anytime you start up a new program, there is a process of working across agencies that is more time consuming than I would like. Setting up processes and procedures, took us awhile, so that we didn't get those grants out the door until the end of the fiscal year last year. The reports that we are getting right now are still preliminary. We would like to see what the result is of the 30 grants that we awarded. We awarded them to not-for-profits and to Small Business Development Centers in September of last year. So, it is soon. I don't want to be premature in telling you how they have worked. For that reason, we didn't pursue more funding, because we didn't know what the $4 million investment was yielding us, but we do think it is a very good idea, and there is a need for it.

Ms. NAPOLITANO. Great. Well, that answers part of my question anyway.

Another area is the National Women's Business Council, and while I read in here that you are requesting an increase, which may be something that they are well deserving of, I am wondering whether they are working with your Welfare to Work, because a large segment of the Welfare to Work are women. To be able to help them become the new entrepreneurs and being able to assist the Women's Business Council do that outreach, what is SBA recommending or what is being done in that area to bring them together to be able to promote new entrepreneurships?

Ms. ALVAREZ. I may ask Sherrye Henry. I don't think Amy is here. I didn't see Amy, but if Sherrye is here, you may want to comment on this issue, Sherrye. Sherrye runs our Office of Women's Business Programs. And we have really tried to work across departments and across agencies on this issue of Welfare to Work.

The National Women's Business Council really is positioned to play a very important role. We are seeing an explosion of women-owned businesses, which is why we are asking for an increase. Not enough research is being done. There are topics that we are not able to research, because we don't have the funding; that is part of what this will cover. We are getting requests at the State level for us to be involved. We can't do it without more resources. Because the States now want to set up their own councils.

There is an interest in bringing together local policymakers with woman business owners to conduct summits, to help them really develop legislation and regulations and other programs to support women's entrepreneurship. All of that requires support.

Sherrye, would you like to comment?

Ms. HENRY. Yes, I am Sherrye Henry, and I run the Women's Program.

I think it is important to know that our Women's Centers—and we have a network of about 80 around the country—work very hard to move women off welfare. We have been very successful at it. In fact, about 20 percent of all of our clients are welfare women, and the number of low-income women is up in the 40 percentile. We are very concerned already with this population.

Ms. ALVAREZ. Through the Microloan Program, for example, more than half of our microloans are going to women, and these are, again, low-income women, which is why we would like to double that program. It makes a huge difference if they can access a small amount of money accompanied by technical assistance. Many of our Women's Business Centers are actually microlenders as well. So, it really is an integrated strategy.

Ms. NAPOLITANO. Good. May I suggest that for any of the research that you may be wanting to ducktail with, a lot of the educational institutions—the universities and junior colleges—have done a lot of research on the population and the business and the impact on the economy. So, may I suggest that you bring them as partners, because they have already done part of it if not most of the research that might be able to help you, and you may be entering into some kind of agreement with them to be able to add another segment to be able to provide what you need.

Ms. ALVAREZ. I think that is good advice. In some cases, we may be doing that already, but I think we need to expand it. Thank you.

Ms. NAPOLITANO. Thank you.

Ms. JONES. Don't go away Sherrye. Before you leave, I want to ask you a quick question.

Before I ask the question of you, thank you, Madam Chairman.

Chairman TALENT. The gentlelady from Ohio is recognized.

Ms. JONES. Oh, you are back. See, you leave for a few minutes.

Mr. Chairman, ranking member, Director, on behalf of the 11th Congressional District of Ohio, thank you for the support that you have given me in the many—in the couple programs that we tried to do with regard to small business in the district, and I continue to look forward to working with you.

The question I wanted to ask of you, Ms. Henry, was in Ohio the Women's Business Centers are in Columbus and where else?

Ms. HENRY. Well, we have a network of about seven operating centers. They are all graduated centers, Congresswoman.

Ms. JONES. Okay.

Ms. HENRY. They have not been funded by the SBA for a number of years now.

Ms. JONES. Okay.

Ms. HENRY. They are all eligible because of the sustainability legislation that was enacted in the last session.

Ms. JONES. Make it plain to me, what are you telling me? You are saying they are graduated but——

Ms. HENRY. The program was set up by the Congress to sunset. All of the grants were at first only for 3 years, and it was extended to 5 years, and then last session the Congress passed sustainability legislation, which now allows SBA to recompete and refund a limited number of the network of graduated centers. We don't have enough money to refund all of them, but we expect to have about 12 graduated centers refunded by the 1st of June.

Ms. JONES. So, in this budget the process is done. Okay. Thank you very much, Sherrye.

My question goes to the issue of other agencies administering some of the loan programs and other type of programs that provide capital for small businesses. My question is have you assessed their success as compared to the success of SBA when SBA administered those programs? And if you have, could you provide, at least I am interested for my district, are they doing better, are they doing worse, what could happen to improve it? Because very often, we do something to improve or cut down on the administration process, but its result is to have it not be advantageous to the small businesses themselves. I have no knowledge one way or the other, but I think it might be a useful evaluation for SBA as well as the Committee.

Ms. ALVAREZ. First, let me say that SBA is the premiere lender to small businesses in the United States.

Ms. JONES. Yes.

Ms. ALVAREZ. We believe just by virtue of our experience, and as I think you saw with our presentation, as we modernize that we are on the cutting edge. And our numbers, the fact that we are projecting $20 billion in overall activity, including leveraging of private capital in the year 2000, is a success story that I think can't be told with respect to small business anywhere else.

Charles, you may want to comment. Obviously, the Department of Agriculture has a program that addresses small business needs in the agricultural area; HUD has its version of our program.

Ms. JONES. Maybe my question wasn't clear. The question I am raising is that at some point SBA decided to allow other people to certify a business for a loan, like banking institutions and the like. And I am asking have you assessed whether or not, now that that certification happens in an institution other than SBA, whether or not there is an increase in funding for small businesses or a decrease based on the move to another agency? I didn't mean—I think you are doing a premiere lending operation as well, but I am just trying——

Ms. ALVAREZ. You are speaking about the contracting. That is not you, Charles; that is James.

Ms. JONES. I thought maybe I wasn't clear in my question. I apologize for that.

Ms. ALVAREZ. We have always been the agency to certify to 8(a) eligibility, for example, and so we have tremendous experience in that area. We still are the agency who will certify you for small, disadvantaged business status. But in addition—oh, okay, now, Greg hands me this note. He says, "No, she really means the banks."

Ms. JONES. Yes, exactly.

Ms. ALVAREZ. So, we are not talking about small, disadvantaged business. We are talking about PLP, preferred lenders.

Ms. JONES. Exactly. Maybe I should have used your term.

Ms. ALVAREZ. All right. We are just into this jargon here. Okay, I am going to turn this over to Charles to talk about how the Preferred Lender Program is operating. We obviously create the standards, and we review them for compliance to ensure that they are meeting our mission objectives as well as our policy objectives.

Charles?

Mr. TANSEY. Yes. It is a tremendously successful program. I think about 60 percent of our total loan volume is done right now under the PLP, the Preferred Lending Program. We do approve eligibility at this particular point, but, essentially, they are approving the credits under their own credit criteria in light of guidance.

Ms. JONES. I understand that, and what I am asking——

Ms. ALVAREZ. Your question is are they really reaching the people who need the help.

Ms. JONES. I am just asking have you used an evaluation to determine that it is working as well as we conceptually think that it is? And I am suggesting that maybe what we need to do is take a look at that, and then maybe go to some of the institutions and say, "Well, why is the rate in 1999 less than it was in 1998 when we have an increase in businesses happening? What are you doing to keep people from being involved in the process." I hope I am making sense.

Ms. ALVAREZ. Yes, it makes total sense.

Ms. JONES. Okay.

Ms. ALVAREZ. Yes. Do you want to comment?

Mr. TANSEY. We are in fact doing that. Some of the recommendations that we are putting forward right now, for example, the 90 percent guarantee, comes directly out of our discussions with banks as to what they need to do in order to pursue the kinds of goals that we are looking for.

Ms. JONES. I am raising the question, because in my district—I am on Banking and I also am on Small Business, because I would like to know what the banks in my area are doing, and if they are not doing what they ought to be doing, then I want to have an opportunity to sit down and have that discussion.

Ms. ALVAREZ. Well, they are here today. I hope you are going to stay and ask them these questions.

Ms. JONES. I wish I were. They are not here from my district.

Ms. ALVAREZ. They are hearing it. Well, we have national representatives, and I am sure that Tony and others will be happy to respond.

I think you are right. We are working to increase the guarantee, because we have heard from them that that would make a difference. We have set up SBAExpress, because we heard that if they could only use their own applications, they would be willing to accept a 50 percent guarantee, because it would make it so much faster. That is for smaller loans, because we are focused on smaller loans. We have the Community Express pilot in which these same category of lenders are not only making loans but they are providing technical assistance at their own expense. We have had an ongoing discussion with them about what they need to do to meet the mission objectives of the SBA. And I am glad you are saying this with them present, because we say it all the time.

Ms. JONES. I appreciate your responses.

Chairman TALENT. If the gentlelady will suspend just a second. Mr. Wilkinson——

Ms. JONES. I am sorry.

Chairman TALENT. Oh, no, not at all. Mr. Wilkinson is here, and unless there is an objection, I don't mind him answering a question or two. Ms. Tubbs Jones, you are going to have to leave, right, so you can't stay for the second panel?

Ms. JONES. Yes, sir, unfortunately.

Chairman TALENT. We won't open this up to a huge—because other members—but I am sure you don't mind, do you, Mr. Wilkinson, going a little ahead of time and answering a question or two?

Mr. WILKINSON. No, I would be happy to.

One of the issues that I raised in my testimony, and it has been discussed here today somewhat, and that is the subsidy rate estimate. And it has been our position that the overestimate of the defaults in the model has been one of the reasons contributing to some of the changes we have had to make in the program.

If we go back to 1995 when Low Doc Program was rolled out and the 90 percent guarantee, everything was rolling along fine. We had to make some program changes to bring the subsidy cost of the program down, and we moved from a 90 percent guarantee to an 80 percent guarantee, and the loan volume since then has gradually fallen off.

That is one of the issues we need to look at: How can we get the subsidy rate cost down in line with the appropriations that we receive? And appropriations have been dwindling. The subsidy rate has not fallen, so the ability for lenders to propose and implement small loan incentives has been very difficult. And I think that is one of the reasons why we need to keep focusing on the default estimate in the subsidy model, and we need to have a discussion, as I pointed out in my testimony, about a subsidy rate floor. What is the role of the Federal Government going to be in the loan programs? What level of Federal funding will we get? Because as funding goes down and the subsidy rate doesn't move down, that means we have got a smaller program or we have to raise fees or take away program incentives.

Ms. JONES. And I thank you, Mr. Wilkinson for that response, but that is the point I am trying to make: It might not be a bad idea to take a look at that and say, "Hey, how do we adjust—not hey—how do we adjust that to the point that we can"—that is not in the record, right? Strike that. Lawyers can do that. [Laughter.]

Anyway, such that we are really moving down the path of helping small business. And that is my point.

And, Mr. Chairman, Mr. Wilkinson, I thank you. My questioning is done.

Chairman TALENT. The gentlelady raises a very good point. One of the problems is that, and in fairness to Mr. Wilkinson who did step up unexpectedly there, we do send a mixed message, and Congress does it, and the executive branch does it. We say we want you to get more money to small businesses, more money to low-income neighborhoods, more money that is a riskier loan. At the same time, we want the subsidy rate to go down, and we want the default rate to go down, and we want you to square the circle, and it does put them in a little bit of light, but if we don't put them under some pressure, we don't again make the point that we would like to have this done.

The gentlelady from New York had another question or two, I think.

Ms. VELAZQUEZ. Yes. Ms. Alvarez, when the HUBZone Program was designed, you, Former Ranking Member LaFalce, and I, we worked very hard on ensuring that this program did not interfere with the 8(a) Program. So, I would like for you to clarify for the record what the order of procurement preference is for the HUBZone.

Ms. ALVAREZ. Fine, and I will also ask James to join me here.

It has now been almost 2 years since we were engaged in discussion about creating a new program called the HUBZone Program, Historically Underutilized Business Zones. And at the time, one of the concerns that was foremost for the Administration as well as for Members of Congress was what effect this would have on the 8(a) Program. Would it have a damaging effect on the 8(a) Program? That really dominated the discussion apart from the discussion about the virtues of the HUBZone Program, which are many.

We got—we had some very serious discussions, and there are letters on the record attesting to those concerns, and one letter in particular, which I wrote to, at the time, Congressman LaFalce, stressing that we would protect the 8(a) Program. We then put forth, as

I said, almost 2 years ago proposed regulations. In those regulations we presented an order of preference, and the order of preference had 8(a) at the top of the list, because we wanted to ensure that 8(a) would have the first priority in terms of receiving contracts even within the context of the HUBZone Program.

We put it out for comment. We followed the appropriate process, and, frankly, didn't get much in the way of comment that challenged the order of preference we proposed. We went ahead and we implemented it. And, to date, we have seen that there have been HUBZone opportunities for 8(a) and non-8(a) firms. We think that the order of preference protects the interests of the 8(a) Program, of the 8(a) companies, but at the same time it makes it possible for non-8(a) businesses to obtain HUBZone contracts. We have seen it already; it is happening. And that is really the status right now. The current order of preference does protect 8(a), but I don't think it creates any obstacles for non-8(a) businesses.

Ms. VELAZQUEZ. Yes, so that means it will not change.

Ms. ALVAREZ. We are not changing it. Someone else might decide to change it, but we are not changing it.

Ms. VELAZQUEZ. I want to send a clear message that we worked out a compromise, and I think it is 2 years too late for other parties now to be challenging the order of preference, and I just want to make it very clear that it was a compromise that was worked out between this Committee and the Senate side.

Ms. ALVAREZ. Yes. I agree.

Chairman TALENT. I recognize the gentleman from Illinois.

Mr. DAVIS. Thank you, Mr. Chairman. I just have one other question I would like to ask the Director.

Ms. ALVAREZ. Yes, sir.

Mr. DAVIS. In terms of technical assistance, especially to small, emerging business enterprises, how valuable does the Department view that?

Ms. ALVAREZ. The smaller the business, the greater the need for technical assistance. It is the reason why technical assistance is a significant component in the Microloan Program. It is the reason why we are so enthusiastic about PRIME, which is totally focused on technical assistance. It is the reason why technical assistance is a significant component of the New Markets Venture Capital Program.

We just think that particularly with newer, smaller businesses and in underserved communities, that it is not just about the money. It is about helping people who have energy, ideas, willingness, giving them tools to succeed. And, so we can't stress enough how important the technical assistance is. We have seen the success of technical assistance nationwide with the Small Business Development Centers, with the SCORE volunteers, with the Women's Business Centers, with the Business Information Centers, with One Stop Capital Shops—in each case it is really a different kind of support for a different set of needs. There may be times when it appears they are overlapping, but, overall, each one of these programs really targets the needs appropriate to different businesses at the stage of their development.

Mr. DAVIS. Thank you very much. I understand that you have taken the position that I like, that if you give a person a fish, they might eat for a day——

Ms. ALVAREZ. That is right.

Mr. DAVIS [continuing]. But if you teach them how to fish, then they can have a business for a lifetime. So, I thank you very much.

Ms. ALVAREZ. Thank you.

Chairman TALENT. Okay. I have a few more questions, and then we can go with the next panel.

Perhaps you want to have Mr. Walter address this; I don't know.

Ms. ALVAREZ. All right. Greg, come on up here.

Chairman TALENT. But the question that was raised initially about the subsidy rate and how far back we go in looking at experience on defaults.

Ms. ALVAREZ. Fourteen years.

Chairman TALENT. Yes. Which I understand is the average maturity of the loans.

Ms. ALVAREZ. Correct.

Chairman TALENT. So, the idea there is that we want to go back at least as far as it takes, on average, to dispose of loans. Is that the theory behind it?

Ms. ALVAREZ. Yes, yes, so that we can watch the performance throughout the life of the loan.

Chairman TALENT. And I am getting at the difference between the agency's views and OMB, because I think OMB is a looming presence behind a lot of this, and I don't like the idea of the programs this Committee oversees, which we all agree are terribly important, being used as billpayers for other parts of the Treasury, and I will just lay it—I think that is what happens, and I think OMB structures it that way.

Now, a lot of these loans are prepaid, aren't they?

Mr. WALTER. That is correct, Mr. Chairman.

Chairman TALENT. Which means that, yes, maybe the average maturity is 14 years, but that really isn't the average in terms of disposing the loans, because if you included the prepay, the average life of the loans is less than 14 years.

Mr. WALTER. Many of the loans we do make have maturities up to 25 years, especially in the larger real estate-backed loans. So, the 14 years is the average length of time a loan is outstanding.

Chairman TALENT. So, in this case, average maturity is the same thing as average life of the loans?

Mr. WALTER. Not necessarily. It is just a mathematical average, so it isn't necessarily the same thing.

Chairman TALENT. Because my understanding is that the average life of the loans is less than 14 years. And if it is—in other words, if we went to figuring it based on how far back we went based on average life rather than on average maturity, it wouldn't be 14 years. And we are all in agreement that if we don't have to go back that far, then the subsidy rate doesn't have to be this high, and that frees up dollars for other things. I mean, what is your opinion on that, either the Administrator——

Mr. WALTER. I think we would be happy to look at that and see if there is a significant difference between the two and enter into discussions with OMB and see whether there is any ability to look at that.

Chairman TALENT. Now, if there were a difference who would have—would you have the authority to change to average life as opposed to average maturity on your own or would you have to get OMB's approval for that?

Ms. ALVAREZ. OMB.

Mr. WALTER. We would have to get OMB concurrence on that.

Chairman TALENT. I want to ask, could we change that here or would that generate a jurisdictional problem with the Budget Committee? Yes, we have a looming presence here too, so I understand your problem.

Ms. ALVAREZ. So, you can relate.

Chairman TALENT. I mean, let us be clear. It would be one thing if because we were so conservative in figuring this subsidy rate we had an extra pool of money which we put back into our programs; that would be one thing. But it goes to the Treasury and is then spread out all over the budget, and if you can figure out a way to get that changed, I would be very interested in hearing, I can assure you of that.

Ms. ALVAREZ. As Greg says, it would require changing the Credit Reform Act.

Chairman TALENT. Yes, that is unfortunately what we have been told, although the other way to do it is just informally, between the two of us institutionally, put OMB on the spot with the small business communities to get them to change. I mean, for example, the 90 percent default rate and I support—excuse me, the 90 percent subsidy for certain kinds of loans, which I support, that isn't in strict keeping with their standards. In other words, they can deviate when there is enough pressure on them to deviate, and that is true, isn't it?

Ms. ALVAREZ. Well, I think that from the standpoint of judging the safety and soundness, they judge that it will have practically an insignificant effect raising the guarantee to 90 percent on the cost of the program. And, so the judgment is based on the fact that it really doesn't have a noticeable effect on the program.

Chairman TALENT. Which I think if they would let us make that argument, we can make that argument, I think, for a number of these other programs. And this gets to something Ms. Tubbs Jones was getting at. I think the experience of the agency and this Committee in overseeing these kinds of programs is greater than the experience at OMB or Treasury or any other. I just think we do it better. You have been living with it from the beginning. This Committee has been living with it from the beginning, and I don't think we are irresponsible. I would not support a lowering of the subsidy rate—excuse me, a—yes, a lowering of the subsidy rate to a point where it would be risky. I don't want to impair all the credibility of these programs. I think they are the ones, the ones outside this Committee and this agency, who are adjusting these rates for their own purposes, either to make money or for whatever other reasons are at stake.

And, so one of the reasons I was grateful to the ranking member for making sure that we still had oversight over PRIME, because it isn't—to me, I don't hesitate—I have waived jurisdiction over stuff that we had jurisdiction. I want to get things done. So, where I felt it was appropriate to do, I have done that. This is not a turf battle. We just do this better than they do it. And I have pretty much pursued that course pretty consistently, I think.

Would you explain to me more specifically than I now understand it what the BusinessLINC Program is?

Ms. ALVAREZ. BusinessLINC—and that is not Greg's area——

Chairman TALENT. No. If it is all right with you, you are excused, Mr. Walter.

Ms. ALVAREZ. BusinessLINC actually falls within our New Markets Initiative. It started out, in fact it is underway right now, as a collaboration between big business and small businesses. We have been working with the Chamber of Commerce nationally. They have set up branch offices in different parts of the country to create a mentoring networking and in some cases a business relationship with smaller businesses. We think that it is proceeding in a really promising way, but we recognize that we are going to need some resources if we want this to take off, because at some point we need to provide support.

The formula is big business, small business, and not-for-profit community development organizations that help make this marriage occur. These not-for-profit organizations, these economic development organizations, can't just sort of drop everything else they are doing to continue to do this kind of mentoring without some support, and we also need to develop some kind of an infrastructure to institutionalize it. That is why we need the funding for BusinessLINC. There is a lot of support from the big business community, but we need to help it happen.

Chairman TALENT. Right. I am all for mentoring. I think, actually, mentoring is a very promising way of getting small businesses to the point where they can participate on their own. But as you know, this program is not authorized, and we are not even sure exactly what it is and how it operates. And I am always a little concerned when the agency requests a substantial appropriation. The staff tells me $6.6 million on a program that isn't authorized. So, this is an area that we are going to want to go into more with you and with staff to make certain that this—particularly, does the money go to the larger businesses?

Ms. ALVAREZ. No, it doesn't. And we didn't seek authorization, because we are not providing grants where we would certainly come before the Committee for authorization. We are really going to be allowing these organizations to compete for contracts to help create the—mediate and create the relationship between the big and small businesses.

Chairman TALENT. When you say these organizations——

Ms. ALVAREZ. In other words, not-for-profit organizations who would have expertise in the business development world so to put together the big and the small businesses and monitor and move along these relationships.

Chairman TALENT. But they will be applying for grants, won't they? How else are you going to——

Ms. ALVAREZ. No, we won't do it through grants. It will be a competitive contracting situation, which is what we do now. We have the authority to do that now in most areas. That is why we didn't——

Chairman TALENT. So, this will be—can you give me an example of maybe the kind of organization that would apply for this contract?

Ms. ALVAREZ. James, do you want to share some examples here?

Mr. BALLENTINE. Mr. Chairman, one of the good examples that we often use is related to an organization that is affiliated with the Washington Board of Trade here in D.C. It is called the Community Business Partnership Project. They launched such an initiative that we are dealing with now with BusinessLINC 2 or 3 years ago. Today the project really works with 45 local businesses, and they, as the Administrator said, attempt to match those businesses that they work with, the small businesses, with their already established large businesses in the community.

As a result of these relationships that they have established in working with both sides, the large and the small businesses, they have created 60 jobs by just bringing these small businesses together with the large businesses for technical assistance and for sub and prime contracting opportunities.

While SBA has many outlet points, we don't have this type of expertise, but these economic development type organizations, such as the Community Business Partnership Project, have this expertise. What they really need is seed money to get this started to do this.

Chairman TALENT. I get handed a lot of notes too. So, would this be like a community development organization might do this or a local chamber or any of the above?

Mr. BALLENTINE. Exactly.

Chairman TALENT. And, so it sounds kind of like a grant to me. I mean, what do you put out specs for a contract in a particular area? You want to up this mentoring in a city or something, so you put out specs for that city?

Mr. BALLENTINE. Exactly, under a contract.

Chairman TALENT. And then they bid for the contract.

Mr. BALLENTINE. Yes.

Chairman TALENT. So, this would be local, like in regions you would do it. You identify regions that need——

Mr. BALLENTINE. We would identify regions, particularly those in low- and moderate-income areas that, again, traditionally do not have this type of investment opportunity and do not have many large businesses working in those communities. So, we would identify areas.

Chairman TALENT. Have you got regulations about how this operates or something in writing for us to look at?

Mr. BALLENTINE. We would be happy to meet with you and your staff as well as the staff of Ms. Velazquez to go over how we would lay out the project.

Chairman TALENT. How much has been appropriated for this in the past?

Mr. BALLENTINE. This is a new program.

Ms. ALVAREZ. This is brand new. This has been operating as a voluntary initiative.

Chairman TALENT. Okay. So, you have done it out of existing funds without making it——

Ms. ALVAREZ. Yes.

Chairman TALENT. Is this a separate line item this year? Is this the reason this has come to my attention for the first time?

Ms. ALVAREZ. Yes, this is the first time. We think that there has been enough demonstrated potential here that if we were to get some funding, we might really have it take off.

Chairman TALENT. All right. Staff tells me you got $1.5 million last year. Is that a separate item or was that——

Mr. BALLENTINE. We received $1.5 million, but the BusinessLINC Initiative was linked to the New Market Venture Capital Initiative which did need authorization. In Fiscal Year 2001, we are not seeking authorization, because we are simply not going through the grant process.

Ms. ALVAREZ. It was a different proposal, Mr. Chairman. When we first started this as a voluntary effort, it was conceived by James' predecessor, Richard Hayes, as a grant-making program, so we sought authorization as part of the New Markets Initiative. But when we revisited that issue, it didn't appear to me that this needed to be a grant program, that this could be a competitive contracting situation, and so we delinked it, and now we are requesting $6.6 million.

Chairman TALENT. You delinked it from NMI.

Ms. ALVAREZ. Yes.

Chairman TALENT. Okay. Well, I just want to, just to let you know up front, I believe in mentoring. I certainly don't want to inhibit the agency from taking these kinds of initiatives. But, for example, I am just sitting here thinking we don't have any standards for measuring results or accountability or anything like that. If the program is unauthorized and we don't have from the agency some set of standards that you are going to follow——

Ms. ALVAREZ. We will be happy to sit down with you and any members of the Committee and share with you our approach, our standards, the plan, and get your input on what makes sense.

Chairman TALENT. All right. Well, I am going to direct the staff to do that on a quick basis, because I don't want to hold up this authorization bill. But I may—and I haven't talked with the ranking member about this, but we may want to do something in this bill on this, because you are going now to a pretty significant amount of money. I mean, $6.6 million. We talked about some of the needs that haven't been met, and I want to make certain that we know how this ducktails with other programs, what areas of the country you are picking to go for, what the standards are for the specs, all that sort of stuff, and we don't really have that yet. So, I think we are going to have to look into that.

I am told that the other services line item in your budget increases from $44 million to $85 million. Can you give us a summary of the items that were covered under that and why you need an additional $40 million for that?

Ms. ALVAREZ. Greg is telling me that these are the non-credit programs.

Mr. WALTER. Mr. Chairman, a number of the non-credit programs are not executed through grants, but we use contracts and other vehicles to do that. If that is the case, then they would be shown in the other services line instead of the grant line. So, a lot of the increases you see there is for those non-credit programs that you have heard us talk about today.

Chairman TALENT. Okay. Give me some examples now of what you are talking about, so when you say non-credit——

Mr. WALTER. For instance, HUBZones is an example. We have a specific line item for HUBZones, and to the extent funds for the HUBZone Program are spent as a contract or things under object class 25, as defined by OMB, they would be shown under the other services line. So, a significant portion of the HUBZone money would be going out in contracts to do outreach and other types of things, so those funds would be shown under the other services line.

Chairman TALENT. All right. Do you have a breakdown of which programs this extra $41 million is associated with so you can tell us it is the contracts for HUBZones, it is the contracts for PRIME or whatever it is?

Mr. WALTER. Certainly, we can provide that to you.

Chairman TALENT. Yes, I would be very interested, because, again, we are talking about a significant amount of dollars, $41 million.

So, you are saying reason having to do with how you submit your budget, you don't include that in the line item of the program with which it is associated.

Mr. WALTER. There is a separate object class breakdown that is required in the budget where you take the entire request for the agency and break it by sub-object class. So, depending on how the funds are spent, whether they are on compensation and benefits or grants or other services or travel, we have to allocate them into those various buckets. So, what you are seeing is the allocation of the agency's budget into that category called "Other Services."

Chairman TALENT. Why the reason for the big jump this year?

Mr. WALTER. Because of the increases that we are asking for in the various programs, such as HUBZones going from $2 million to $5 million. If the majority of that increase is in that one object class area, you would see an increase in that category.

Chairman TALENT. Okay, I am informed that there is a $41 million increase in other services. That is what I am talking about. But, in addition, a $40 million increase in grant subsidies and contributions. It sounds like two kinds of catch-all categories. What is the difference between the two of them?

Mr. WALTER. That is correct. It depends on how the funds are actually spent by the agency. If we put them out in the form of a grant, then they would be shown in the grant line. If we put them out in the form of a contract, then they would be shown in the other services line. So, what you are seeing in the two categories is generally the total increase that we have shown in the budget for the non-credit programs. For instance, the PRIME Program, the $15 million, or the E-commerce Program. Those types of programs would be distributed between the two object-class categories depending on how we spend the funds.

Chairman TALENT. Okay. Well, I would like that breakdown, and we would like that expeditiously.

Mr. WALTER. Absolutely.

Chairman TALENT. And, also, I am told by staff, Ms. Alvarez, that sometimes we have made requests subsequent to these hearings for information, and it has taken some time to get them to the Committee. Now, I was not given specific instances, but figures like three months were given to me. It took that much time to get requests answered from the agency. That strikes me as too long. I am sure it strikes you the same way.

Ms. ALVAREZ. Yes.

Chairman TALENT. So, let us expedite information requests.

Ms. ALVAREZ. Yes, I agree, I agree.

Chairman TALENT. I don't want to get anybody in trouble, maybe I do. It just depends on——

Ms. ALVAREZ. We will talk later.

Chairman TALENT. Okay.

We have this markup coming up very quickly, according to the plan, and the ranking member and I would like to bring this up next week. So, we are going to have to move pretty quickly. We don't want to have to keep postponing this. But those are some issues I think we need to address, because there is a lot of money in those two areas I just covered.

Ms. ALVAREZ. Mr. Chairman, the overall increase in this budget is $185 million over last year. And 1 percent of that increase goes to the disaster funding, which we are fully funding; 6 percent of the increase goes to new programs; 14 percent of the increase is to the existing traditional core SBA programs. So, the majority—the largest part of the increase is to our standard SBA programs and then to disaster, and really a smaller fraction goes to the new programs.

Chairman TALENT. I made one note to myself, which I can't find because of all these other notes people have given me. Where is the note about the NMI stuff I want to bring up? Don't take my note until I am done with it. [Laughter.]

Let me go a little bit into your presentation on NMI just to make some points. And we, as you know, are working up that bill with you on this.

Ms. ALVAREZ. I appreciate that.

Chairman TALENT. You made a point measuring—or it may have been Mr. Ballentine who made this point, I don't know—about the number of jobs that were associated with NMI.

Ms. ALVAREZ. Yes, that is right. That was a point I made.

Chairman TALENT. Now, is it your anticipation that we would measure performance from these NMI investments by jobs created? And let me tell you why I would have some concern about that. We all expect and hope and would be very pleased with job creation from these investments in these low-income areas, and there will undoubtedly be some.

Ms. ALVAREZ. Yes.

Chairman TALENT. I think it is a mistake to overemphasize that going in because of all the collateral benefits that we get from small business creation in these neighborhoods, even if there isn't an immediate or a very substantial impact on jobs in the neighborhoods right away. In part, just renewing, if you will, the infrastructure of those neighborhoods and having the functioning small contractor with his headquarters in that neighborhood is a tremendous plus even if you don't go out and hire right away a bunch of folks from the neighborhoods. Obviously, we hope that happens, but it means that when the child walks to school in the morning and is going by the drug store, says hello to the guy—you see what I am getting at? And, so give me your thinking on that. You are not tying this directly to job creation.

Ms. ALVAREZ. When I made the presentation and talked about the job creation, I used the word "long-term," because in the New Markets Venture Capital Program, you are talking about investments in growth companies but companies that will need significant involvement, hence the TA component on the part of the investor. These are companies that are already a going concern, that are promising, but they really need expertise, hands-on management to really make them take off. And about patient capital for these New Markets ventures, we are talking about not paying interest for a period of 5 years. We want to allow these companies an opportunity to produce a return, and it is not going to happen immediately. So, it would not be wise to judge the success in terms of immediate job creation.

In studying the results produced by the community development venture capital companies, they look at job creation ultimately as one of the outcomes of telling the success story, and we should look that way too.

Chairman TALENT. Yes, no question. I think—tell me if you think we are in disagreement here. I don't think we are.

Ms. ALVAREZ. No, I don't think so. I totally agree with you. I made the point, though, because if you look long-term and you look at the investment, it really is a very modest cost to create those jobs.

Chairman TALENT. I think that is true in the longer-term. One of the gripes I have about the current enterprise-owned system is that the only tax relief in there is for hiring folks from the neighborhood, which is a very good thing to do, but people don't open businesses to hire employees. They open businesses to eventually make money to support themselves, and if we lose that focus, if we go wrong—one of the tricky things about this is if you go wrong with the focus at any point, the program can end up being ineffective.

So, as long as we are in agreement that, yes, this is a benefit we expect to enjoy in the longer-term but it is not a criteria for performance measurement necessarily in the short-term, then we are in agreement. I do agree totally with you that not only will it create jobs, maybe even more important, be a model for entrepreneurship for young people in that neighborhood. So, even if it doesn't create a job, they go start their own business then, which——

Ms. ALVAREZ. That is right, that is right.

Chairman TALENT. Now, another point you mentioned about NMI investments and you said, okay, one of the reasons the program is expensive is that we do expect losses. I think you said that, didn't you?

Ms. ALVAREZ. We are using the most conservative estimates. The analogy would be the kind of subsidy rates that we estimated for the SBIC Program not too long ago and in the Microloan Program where we started off using very conservative estimates, and over the course, really, of a relatively short amount of time, we saw in actual experience that we were too conservative. In fact we didn't require as much. And we expect that those experiences will be not unlike what we will experience with the New Market Program.

Chairman TALENT. You said there is going to be—I think you said it is going to be mission-driven rather than profit-driven.

Ms. ALVAREZ. Obviously, the investors will want a return on investment. This is not throwing away money, but to the extent that they won't expect the same kind of return that the SBIC investor would expect, it is mission-driven. To the extent that we are talking about patient capital so that you don't expect an immediate return but you expect it down the road, and to the extent that these New Markets Venture Capital Companies will be located in those communities, they will know those communities and will be investing in the well-being of the community not simply their own profit motive. That is the distinguishing characteristic.

Chairman TALENT. No question about it. Would you agree with me— I hope you do—that it is a very fine line we have to walk here, because one of the—where something is investment-driven in the sense that people expect to go in business from which the investors get a rate of return, you have a hedge against a lot of things that you don't want entering into that program.

Ms. ALVAREZ. Correct.

Chairman TALENT. Because once decisions are made other than on those criteria, unless you are very careful, you start having to declare what is the mission? Who gets the investment? And I am not going to be here after this year, and—well, I don't know whether you will still be in control of the agency or not—but we don't know what will happen a year, 2 years, how decisions will be made if they are not made based on we expect to have a working, functioning business there that is eventually producing for the investors. Do you see what I am saying?

Ms. ALVAREZ. Absolutely.

Chairman TALENT. It isn't so much that profit is the key. It is that profit is a way of not letting other considerations enter into it—who knows somebody and therefore gets the investment.

Ms. ALVAREZ. There is a profit motive, and, I don't know if you want to comment, Don Christensen.

Chairman TALENT. Yes, I know—this is worth a little extra time, and I know the members have been patient, but this is an important program, and if he would like to comment, I would like to have him comment.

Ms. ALVAREZ. These programs are meant to produce a return on investment, and they are meant to be investments in growth companies.

Don.

Mr. CHRISTENSEN. Yes. I am Don Christensen, the Associate Administrator for Investment.

Yes, a fundamental concept of the New Markets Venture Capital Program is that it is sustainable. If you have an investment program, to be sustainable, you have got to have a profit. Now, the difference that the Administrator is referring to is our SBICs target profitability of between 20 to 30 percent per year. Those profits will not be available in the LMI areas that we are trying to address.

So, for those funds to be redirected toward LMI areas, there has to be a mission component. It is what we speak of as a double bottom line, that you make a profit, but you also look at some of what you have contributed to the community. And the contribution is, as you pointed out, more than just employment.

One of the things we speak of is that we are trying to build wealth in the community. The wealth is both economic, being able to stand up and be proud of your community, to feel it is safe. These are the things that small business can make a very significant contribution to.

Chairman TALENT. Now, the contribution to the community, isn't the establishment by somebody of a functioning small business in a community that doesn't have a good skeleton of that, that is the contribution. We are not going to ask them, Okay, in addition to this, you have to attend every board of alderman meeting and fight for community policing in your area and this sort of thing. We assume they will do that, because we want their businesses to be successful, right?

Mr. CHRISTENSEN. Yes, sir.

Chairman TALENT. Okay. That is fine. I mean, I hear what you are— if what you are saying is we are doing what all our programs do at some level is skim below where the market might generate on its own——

Ms. ALVAREZ. Exactly.

Chairman TALENT [continuing]. And get some others that are slightly riskier but will be sustainable, and that is the mission you are talking about. That is the line I think we need to walk.

Ms. ALVAREZ. And I think that word sustainable is very important, because it means that you expect something.

Mr. CHRISTENSEN. We expect earnings of the order of 8 to 10 percent per year for the new market investment.

Chairman TALENT. I want this to work. I want it to work. I don't want any 5 years down the road some huge—some expose on 20/20 from the same people who are screaming now that we need to do this, and then a few years from now they say, "Oh, it didn't work, so-and-so got this." So, as long as your conscience of that, we are all on the same page. We may disagree on the details, but we are going in the same direction.

Ms. ALVAREZ. That is right.

Chairman TALENT. That is, I believe, all I have unless you have another note to pass to me. Do you have any more notes or questions? Okay.

I thank you all. It has been a very good hearing so far, and we have another panel.

Ms. ALVAREZ. Thank you, sir.

Chairman TALENT. Thank you, Ms. Alvarez.

Mr. DAVIS. Mr. Chairman, I have a young brother traveling with me today. I just want him to be——

Chairman TALENT. Well, why don't you put his name on the record, if the gentleman wants to do that?

Mr. DAVIS. His name is Greg Creole. He is part of a program called Talent Search, and what they are doing is growing cucumbers. [Laughter.]

Chairman TALENT. Well, thank the gentleman for introducing him.

We will have the second—he looks sufficiently below the constitutional age that I don't think the gentleman from Illinois has any concerns from him in the short-term.

[Recess.]

Chairman TALENT. We have already had a taste from Mr. Wilkinson, and our appetite having been wetted now, we are eager to get onto the second panel, who all I think are veterans except Ms. Hayashi. This is your first appearance; welcome.

Other than Ms. Hayashi these are the usual suspects. We have rounded them up and gotten them before the Committee.

All right. Rather than introduce everybody and then reintroduce them, we will just start off with Mr. Tony Wilkinson, who is the president of the National Association of Government Guaranteed Lenders.

STATEMENT OF ANTHONY R. WILKINSON, PRESIDENT, NATIONAL ASSOCIATION OF GOVERNMENT GUARANTEED LENDERS

Mr. WILKINSON. Mr. Chairman, Ms. Velazquez, thank you for inviting us here today. We appreciate the opportunity to testify on SBA's budget request.

You have my written statement for the record, so in light of the fact that we are running a little late today I am going to abbreviate my testimony.

Chairman TALENT. Well, as to that, let me just say that this is the only hearing we are going to have specifically for this purpose, and I felt it important to give everybody the full opportunity. So, whether we are late or we just had a full exposition, I think it was necessary.

But I do appreciate you all summarizing. You all have testified many times, so just tell us what you think is important.

Mr. WILKINSON. Sure. First, I want to thank the Committee for your consideration and passing of H.R. 2615 last year. We look forward to that moving forward this year. As you know, that includes a prepayment provision that we think is necessary in our program.

The Fiscal Year 2001 budget request confirms that we are incurring higher costs in this program due to prepayments. Specifically, the subsidy rate increase is primarily the result of an increase in the loss of fee income due to prepayments and the Treasury earnings on these fees.

Chairman TALENT. What luck have you had in convincing our counterparts in the Senate of the need for change in that area?

Mr. WILKINSON. We continue to have dialogue. We are trying, we are trying.

Second, I raise the issue of our funding shortfall for this year, and we are pleased to hear today from Administrator Alvarez that efforts are being made to address the 7(a) shortfall.

Next is the Fiscal Year 2001 budget request, and we agree with SBA that we will need $11.5 billion net for the 7(a) Program, as we estimate that to be the demand for the program next year. We detail our recommendations for authorized levels for 2001, 2002, and 2003: $14.5 billion for 2001, $15 billion for 2002, $16 billion for 2003. These amounts should be sufficiently above the current budget levels to provide flexibility of the Appropriations Committee should a change in the economy necessitate consideration of a higher level of loan guarantees without the necessity of authorizations being changed.

I would like to thank SBA Administrator Alvarez and her staff. We have had an excellent ongoing working relationship with her and her staff. I don't want the discussion of the subsidy model and the excess—the conservative estimate of defaults in the model to overshadow the fact that we have had an excellent, ongoing working relationship. We are pleased with the budget request; shows that the 7(a) Program continues to perform well. The recovery rate on defaulted loans remains high, but unfortunately the subsidy model does include a default estimate that we continue to believe is materially overstated.

And, so I thought I would just spend a minute on what happens—or some of the discussion that occurred this morning. I am no expert on this entire budget package, but in looking at the budget for Fiscal Year 2001, there is a line item on the status of guaranteed loans. It shows that the outstanding balance of guaranteed loans at the end of the 1999 was $36 billion. We did $9.5 billion last year and roughly $9 billion each the 3 years before. So, my simple math tells me that we have spun the entire 7(a) Program out in 4 years.

I know that is simplistic, and that is not the right answer for the average life of the loan, but it is a lot less than 14. It is probably more than four, but there is a number of somewhere in between that better reflects what is actually happening in this program.

So, I would hope that we could continue to have dialogue on the estimate of defaults in the subsidy model. Perhaps your staff can meet with the Budget Committee staff, a joint hearing, a letter down to OMB, something to have a discussion about what is going on with the default estimate.

I also heard Mr. Walter say today in his comments that they thought the range of defaults was from 8 to 12. Yet, in the model, they use 14.25. Why not at least the highest level of the range they anticipate of 12. That was what I understand to be about 34 basis points per 1 percent decrease in default estimate. That is a lot of money to either reduce the subsidy rate so we need less appropriations or we now have some subsidy dollars to spend on small loan incentives. So, again, I hope that we can continue to take a look at that.

Mr. Chairman, I raised briefly, when I was up at the table earlier, the concept of a subsidy rate floor, and since we have already gone through that once before, I won't do it again. We would ask that that be considered.

And I would like to close today by saying that since this will probably be the last time I appear before you as chairman of this Committee, I want to thank you for the leadership that you have brought to this Committee, and I appreciate the bipartisan effort that you and Ms. Velazquez have brought to Committee affairs.

[Mr. Wilkinson's statement may be found in the appendix.]

Chairman TALENT. Thank you, Mr. Wilkinson. I have a lump in my throat, I think.

Mr. Lee Mercer, president of the National Association of Small Business Investment Companies.

STATEMENT OF LEE MERCER, PRESIDENT, NATIONAL ASSOCIATION OF SMALL BUSINESS INVESTMENT COMPANIES

Mr. MERCER. Thank you, Mr. Chairman and Ms. Velazquez and members of the Committee who will be considering the testimony. And I would like to echo Tony's remarks regarding appearing before you and working with you and your staff and the bipartisan way in which this Committee has been run. It is really a model for how legislation ought to be done, and I think you are both to be commended.

The SBIC Program is in the best shape of its long history and providing substantial money in equity investments and subordinated debt investments to small businesses, $4.2 billion in Fiscal Year 1999. If you did it on a calendar year basis, $5 billion in calendar 1999. More important than just the gross number is the size of individual investments. You heard the testimony from SBA about the private venture capital funds investing at the rate of about $6 million, $7 million, and even up to $10 million per deal, per investment.

For all SBIC investments, the average is about $1.4 million, but what is more impressive is the median. The median is only $375,000, and for debt SBICs that are making subordinated debt investments, the median drops down to about $181,000. So, clearly, there are a substantial number of transactions going on at the very lowest levels of capital necessary.

This is true. About 34 percent of all SBIC investments last year were made in companies that had been in existence for less than a year, and if you raise that bar to 3 years, it jumps up to over 50 percent. So, those are the companies that need—with the exception of dot.coms that burn substantial amounts of money, those are the companies that need these smaller levels.

The other interesting note is in the technology area, SBICs probably invested about 27 percent in technology-oriented businesses, and in the private world it is much higher of course, mainly driven by Silicon Valley and other areas.

As far as——

Chairman TALENT. Lee—and I would encourage the ranking member also to jump in if she wants to. Unless she has a problem, I will keep this informal. Is that because of incentives or persuasion from the Government that your portfolio looks different? Is that just the nature of the way this investment operates?

Mr. MERCER. No, it is just the nature of the business. What you have, I think, in the SBIC Program more than in the strictly private funds is a couple of things working. One, SBIC managers are always looking for a niche. They are profit-driven, so they are looking for niches. They come from probably more varied backgrounds than perhaps some of the managers of the strictly private funds. They end up looking at probably more Main Street businesses because of that, because of their backgrounds. Also, they are investing much smaller amounts, and that kind of drives them into more Main Street businesses also.

When you are managing a $500 million fund or even a $1 billion fund, like a private fund manager is, you are going to have to be investing $10 million, $15 million, $20 million at a time. So, the only way you are going to be able to put that kind of money to work is to look for a business, typically a technology business, that has a significant burn rate for capital in its development years. So, those are some of the things. It is just the market dynamics that are at work, and good ones for small business and the SBIC Program.

As far as the—does that answer the question? We can pull more statistics if you want, but does that get at the question?

As far as the budget is concerned, we support the budget with what we understand to be the amendment that is going to be coming from the administration. For participating securities, they have proposed $2 billion which would cost an appropriation of $26.2 million, and that level, which is a 33 percent growth in available leverage for only a 7.8 percent increase in appropriation, we think is well justified by the growth of the program. All participating security leverage has been used for the last 2 or 3 years. It is the program that has the steepest growth rate.

With regard to the Debenture Program, although the budget submission calls out for a positive subsidy rate of 0.78 percent, which would require a $3.9 million appropriation to support $500 million in debentures, SBA and OMB have now admitted that a simple mathematical error was done. I don't want to get into an argument about what should be the subsidy rate formula. We are not—we just said to them, even using your formula, it doesn't make sense. And they went back and checked their math, and in fact there is no positive subsidy rate. In fact, the subsidy rate fell by over a point, so it is a negative subsidy rate, and we understand the OMB and the Administration will be proposing to change the law that imposes the mandatory 1 percent interest that was imposed in 1996 to reduce that for the Debenture Program this year to 0.88 percent for the leverage that will apply in Fiscal Year 2001. And we would support that, obviously.

So, the availability of debenture leverage next year will literally be driven by whatever the authorization levels are that the Committee decides to insert in the language of the reauthorization bill.

As far as suggested levels for reauthorization, in my testimony I have said for debentures $1 billion in 2001, $1.5 billion in 2002, and $2.0 billion in 2003. For participating securities, it would be $2.5 billion in 2001, $3.25 billion in 2002, and $4.0 billion in 2003. For participating securities, clearly, the growth curve supports those numbers. On the debenture side, although the utilization is nowhere near those numbers, we feel that there will be—there are things in play right now that may increase the likelihood that a greater number of debenture—more debenture leverage will be used, namely the zero coupon debentures that are not yet available that will be available to SBICs for making investments in LMI areas, and also the fact that last year Congress, with your leadership, passed a bill which would make the use of royalty agreements much more attractive to SBICs. Actually, they weren't attractive at all, but under the new legislation they will be. SBA has yet to issue their implementing regulations, but when they do, we believe we will see more debenture use there as well.

Importantly, I would like to draw your attention to the four proposed changes to the Small Business Investment Act that we have proposed. We have dealt with both your staffs on these, so I don't want to spend a lot of time on them unless you have questions of me, but one of the changes has to do with the subsidy rate and allowing the administration to have continuing authority, like in the 504 Program, to adjust the subsidy rate when the model shows that it goes below zero.

The other three amendments pertain to the operations of SBICs and, more importantly, to the resources that SBA has to expend in regulating SBICs. In the first case, we propose that SBA's definition of long-term, which they say is a 5-year period, be reduced to be 1 year, and this would put, for all SBICs, a definition that they have already made for companies in LMI areas and that they proposed for their New Markets Venture Capital Program. It is really just a recognition of the fact that in this environment, as in tax law and accounting law, the term "long-term" is denoted by a period greater than 1 year. SBA has recognized that for LMI investments, and they should recognize it for the entire program.

The second is with respect to control of a small business that has been invested in. SBA has a imposes a blanket prohibition on an SBIC controlling a small company, having a controlling interest in a small company that it invests in. It then sets out four broad exceptions. You can take control for up to 5 years where reasonably necessary for the protection of your investment, if there has been a material breach of the financing agreement, if there has been a substantial change in the small businesses operations or such a change as intended by the financing, and the SBIC and the investor group is providing a major source of the capital, or in the case of a start-up. So, you can see that what they have done is given four exceptions that cover almost every conceivable thing you can think of in providing financing to a growing small business.

So, what happens? SBICs are forced to jump through hurdles to try to comply with the exception rules, and then SBA spends an inordinate amount of time and resources when they go out to examine an SBIC to make sure that all the exceptions have been complied with, and the exceptions pretty much take up the universe.

In the Gramm, Leach, Bliley Act, that bill recognizes it, and for the first time, under that act, banks will be able to have venture capital funds without regard to having an SBIC license. This will be the first time in history that has been allowed. In that act, the way they deal with the control is they specifically say in the Gramm, Leach, Bliley Act that the venture capital firm, the bank venture capital firm, can take control of the small business during the investment period. Well, SBA's exceptions permit it for up to 5 years which is typically an investment period. So, we say that should be changed.

And the final one is another one which is just technical in nature which would permit SBICs to make tax distributions once during any calendar quarter. The law right now says they can only make it at the end of the calendar quarter. What happens is that SBICs like to make distributions as quickly as they can in order to make higher internal rates or returns for their investors. So, they make a distribution as soon as they can in the quarter, and then they make another tax distribution at the end of the quarter. Well, each time they make a distribution, they have to fill out sets of forms, and SBA has to review them. So, we think that if you change the rule—and I think SBA would be supportive of this—it would just, again, reduce time and effort by SBA.

Chairman TALENT. Lee, I am going to have to ask you to suspend or we are going to miss the vote.

We will be right back.

I understand Mr. Wilkinson has to leave to catch a flight, and neither Ms. Velazquez nor I have further questions, although we may submit some to you in writing. So, thank you for coming, Tony.

And we will be back in a few minutes.

[Recess.]

Chairman TALENT. Okay. Mr. Mercer, by our timing you have been on for 30 minutes, but do you have any closing comments? I have to say the Committee wasn't actually in session during that entire period of time.

Mr. MERCER. But I want you to know that I thought about it for 30 minutes, and the only thing I would close by saying is the four suggestions we have made, at least three of them would simplify the regulations. This guide to the SBIC Regulations is what we publish each year for SBICs. Over 600 pages. It is the regulations, the forms, the policies, the procedures. It is everything an SBIC needs to know, and it is obviously a complex program. So, we think that the changes we have suggested will take some of the complexity out.

So, I am going to stop now with just two more comments: One, although SBA has left, I would like to commend SBA for the work they have done in supporting the SBIC Program, sometimes without enough assets, and in terms of personnel we have been told that Administrator Alvarez has allocated another 15 people to the SBIC program.

Chairman TALENT. I was going to ask you about that. So, you think that will clear up the backlog in applications?

Mr. MERCER. Well, there is obviously going to be a learning curve and a hiring curve. Of that, Mr. Christensen has the ability to hire 5 from outside the agency, we have been told, and 10 from inside the agency. So, there will be some lag, but for a program that has grown over 280 percent over the last 4 or 5 years they obviously need some new help, and I think at least we have been told that help is on its way.

I would just like to close, in a sense, where I began and thank you both and your staffs for taking the time to really try to understand what is an exceedingly effective but exceedingly complex program. It really is performing up to the expectations of Congress. We think it can do more, but it is a pleasure to work with you, and we look forward to continuing that work.

Thank you.

[Mr. Mercer's statement may be found in the appendix.]

Chairman TALENT. Appreciate your comments very much, Lee.

Next witness is John Giegel who is the vice president for Congressional Relations at the National Association of Development Companies.

Mr. Giegel.

STATEMENT OF JOHN GIEGEL, VICE PRESIDENT FOR CONGRESSIONAL RELATIONS, NATIONAL ASSOCIATION OF DEVELOPMENT COMPANIES

Mr. GIEGEL. Good afternoon, Mr. Chairman and Representative Velazquez. I also want to thank the chairman and ranking member for their bipartisan cooperation on this Committee. NADCO would like to thank the Committee for your continued support of our 504 Program and the CDC industry, including the passage of H.R. 2614. It was another step towards the improvement and expansion of the 504 Program to the benefit of all our small business borrowers.

It is our understanding that this bill is being considered by the Senate Committee on Small Business at this time, and we would strongly urge the Committee to work with the Senate to obtain quick passage of this bill, which is crucial for the improvement of the 504 Program.

I want to take an opportunity this morning to briefly address certain items in the SBA Fiscal Year 2001 budget. SBA has proposed that the authorization level for the 504 Program for Fiscal Year 2000 in the amount of $3 billion to $3.75 billion. NADCO supports this increase in the authorization ceiling for two reasons: First, we have seen a rise in the long-term interest rates, and we have also seen private sector lenders starting to become a little bit more conservative in their lending practices. And this may be very early in this time frame, but there are possibilities of liquidity concerns, credit tightening, and the increase in authorization will help 504 meet those challenges this year and in the future.

There is also a 3-year reauthorization of the Small Business Act which provides for an authorization for the guaranty authority for the Small Business Administration to provide financing under 504 or the CDC Program, but it restricts the maximum amount of loan guarantees it may provide in any given year.

Historically, legislation has been enacted to provide this program authority for 3 years. The most recent law authorized SBA to guarantee CDC debentures in the amount of $3 billion, $3.5 billion, and $4.5 billion for each of the last respective 3 years. We certainly agree that the next 3 years should be increased to provide debenture guaranteed levels at $3.75 billion for 2001, $4.5 billion in Fiscal Year 2000, and $5 billion in Fiscal Year 2003.

These program authorization levels are not contained in H.R. 2614, referred to the Senate last year, and we urge that they be included in your bill as without program reauthorization, the 504 financing cannot be provided. In other words, we will be shut down without those numbers being included.

We believe these guarantee authorities are in line with expected program utilization, again, particularly as commercial lenders may begin to tighten as the economy might slow down as the result of interest rate increases.

The SBA budget also addresses the subsidy level, and I know the chairman is quite interested in that. SBA's proposed budget decreases the annual fee charged for each 504 business borrower from 0.6 percent to 0.472 percent. This is an actual 21 percent decrease for the upcoming fiscal year, and it is the fourth decrease in a row. Now, certainly, we in the industry have always felt the subsidy rate has been too high, but at least there has been some reflection with the OMB subsidy calculation that the need to continue these high rates has been reduced, and this lowered subsidy rate will in fact result in smaller costs to our small business community.

However, the budget also talks about the industry has a concern about the forecasts, again, contained in the budget concerning the recovery of defaulted loans and also the number of defaulted loans. Historically, 4 years ago, the default rate was around 18 percent, and now it has fallen, and recoveries have also fallen except for the last year. It reached a low of 25 percent, and now it has risen to 31 percent. This does, again, raise the question of the subsidy rate. We in the industry, of course, and the small business community and I believe the participating lending institutions would all agree that the fees are probably too high. And indeed the 504 Program is a positive contribution to the revenue, project revenue over and above total costs.

Chairman TALENT. Let us get into that loan liquidation issue a little bit, Mr. Giegel. I, too, am impatient for more discretion for 504 investors to be able to liquidate defaulted loans. Do you have any idea—we had a pilot. Any idea how well it has done? I know the report isn't ready yet, but do you know?

Mr. GIEGEL. We have only a secondary evidence, but the—and it is a small sample—but, clearly, the pilot liquidation study has shown a recovery rate better than what has been projected. The SBA budget talks about 25 percent to 31 percent. The limited sample evidence that we have not probably puts that close to 50 percent or better, and we only have—there is, obviously, recently an asset sale as well. And while we do not have access to the final reports and the numbers, there is certainly some evidence out there that indicates that the assets sales have resulted on 504s to be considerably higher than the recovery rates posted by OMB.

Chairman TALENT. Is anyone from the agency prepared to comment? Ms. Butler, I notice you are here. Will this report be ready soon for our inspection? I hate to penalize people for sticking around, but——

Ms. BUTLER. Actually, we appreciate it. We are very interested in the outcome of this as well. I am Jane Butler. I am the Associate Administrator for Financial Assistance.

We did issue a report on September 30 that covered the first 2 years of the pilot. Unfortunately, because of the length of time that is required to complete liquidation actions and the pilot only included loans coming into liquidation within the 2-year period, so it is not a complete record of the total activities on all the loans in the pilot. We are continuing to monitor those, and we will report to you periodically.

But what Mr. Giegel said is absolutely correct. We have seen on both the control group, that is the liquidations handled by SBA, as well as those liquidations handled by the CDCs, that our activities show higher recoveries than what have been proven on a long-term basis with regard to the subsidy model. So, we are continuing to watch that program.

Chairman TALENT. Now, if this report turns out to be positive, as preliminary results indicate, you have the authority to move it from a pilot to just a general program where they can liquidate their own defaults; is that correct?

Ms. BUTLER. Actually, the legislation that authorized the program did not have a sunset date, so we are continuing the pilot with the group that was originally participating, and in the reauthorization bill passed by the House and pending at the Senate, you would make the program permanent.

Chairman TALENT. Okay.

Ms. BUTLER. But we are continuing it without interruption.

Mr. GIEGEL. And that is a key element. We are taking, I think, measures included in the House bill, and hopefully to be adopted by the Senate, will make permanent both the Premiere Certified Lending Program, which provides for a reserve by CDCs on PCLP loans, as well as provide for making permanent the Liquidation Pilot Program, which would include a litigation authority to, we think, and working with the SBA, to make recoveries even better. And I think it will be certainly positive for our consideration of the subsidy rate as soon as we are able to let it count.

Chairman TALENT. Okay. Thank you, Ms. Butler.

Mr. GIEGEL. Well, those are the key points of my presentation. We certainly want to thank you, Mr. Chairman, for all your efforts and your past efforts, and all the Committee members and ranking member and the staff for working so well over the last several years. The bipartisan effort has made the 504 Program a better, better program.

CDC are major stakeholders in the 504 Program, and we want to do everything we can to ensure its long-term viability. We have considered these recovery problems, the subsidy rate issues to be a very serious matter, and we look forward to working with your Committee and the SBA in reversing that trend. Only with this effort can we make the 504 fees come back to a reasonable level for all small businesses.

Thank you.

[Mr. Giegel's statement may be found in the appendix.]

Chairman TALENT. Thank you, Mr. Giegel.

Next, Mr. William McCutchen, the executive director of the Association of Small Business Development Centers. Woody, thank you for your patience. Proceed.

STATEMENT OF WOODY McCUTCHEN, EXECUTIVE DIRECTOR, ASSOCIATION OF SMALL BUSINESS DEVELOPMENT CENTERS

Mr. MCCUTCHEN. Thank you, Mr. Chairman and Ms. Velazquez, and I, too, would like to thank you for this opportunity for the association to testify this morning.

I would also like to express our gratification for your leadership of this Committee, leadership that continues an over 20-year tradition of bipartisan interest and support for the SBDC Program, a bipartisanship that has proven very productive and positive for our program.

Today's SBDC Program is truly a national delivery system. We have got over 1,000 locations in all of the 50 States, District of Columbia, Puerto Rico, the Virgin Islands, Guam, and just recently American Samoa. In the last 20 years, SBDCs have provided counseling and training for almost eight million existing and pre-venture clients.

We also would like the record to reflect today our appreciation for the administration's and Administrator Alvarez' decision this year to fund the program at a level of $85 million. We think it demonstrates a new renewed awareness within the SBA of the importance of the SBDC Program and the clients we serve.

We have included a chart in our written presentation that documents the performance of the SBDC Program, performance that we are tremendously proud of. If you look at the chart, in Fiscal Year 1999, our funding was up by less than 1 percent, but in Fiscal Year 1999, total clients—African-American clients, Hispanic clients, women clients—were all up by at least 9 percent, up to almost 16 percent. So, the program is certainly making effective use of the dollars that the Congress supports us with.

This morning, Mr. Chairman, we are asking that this Committee approve and recommend to the full House that the SBDC Program be reauthorized at $100 million in Fiscal Year 2001, $105 million in Fiscal Year 2003, and $110 million in Fiscal Year 2003. We believe these levels of authorization are crucial if the program is to maintain a level service capacity. Additionally, we believe that at a minimum the SBDC Program will need an appropriation of $90 million net of earmark from section 21 funds to address the growing needs of the Nation's exploding entrepreneurial population.

There is a crying need for vastly expanded and more comprehensive small business regulatory compliance assistance. The SBDC is also working with the Association of Disabled Veterans and other veterans' groups to provide improved and expanded services to the Nation's veterans. The program for 2 decades now has utilized the dollars that Congress invested to create a strong and viable infrastructure that includes over 3,400 strategic resource partners. The SBDC Program is the only Federal small business M&TA Program that is subject to a congressionally mandated certification program. The ASBDC also contracts with an independent consultant for a biennial economic assessment of the long-term effects of SBDC clients.

In 1996, SBDC clients experienced sales growth at almost four times the rate of the average U.S. business, and job creation for SBDC clients was 1.29 compared to 0.22 jobs for average U.S. businesses. We have expressed our concerns this year regarding the need for essentially technical changes in our funding formula, and we have also expressed concerns regarding the need to maintain client confidentiality that is so essential to our client relationship. We are most appreciative that the staff of this Committee has always been available to us and extremely helpful.

In summary, Mr. Chairman, the SBDC Program is the Federal Government's largest and most successful small business M&TA outreach and assistance program. The network is well positioned to deliver an increased level of management and technical assistance to a significantly expanded client base if the program is provided the resources to do so by Congress. And we ask for this Committee's support for the program's reauthorization at funding levels that will allow the program to remain innovative and meet the needs of the Nation's 23 million small businesses.

We want to make sure that the record reflects that the ASBDC and SBDC network are solidly committed to helping open doors of economic opportunity for individuals in communities and new markets. In fact, new markets are not new to the SBDCs. In 1999, 42 percent of our clients were women, 23 percent were minorities, and almost one-fourth of our service centers are located in targeted economic revitalization areas, such as HUBZones, empowerment zones, and enterprise communities. SBDCs are therefore well positioned to play a significant role in publicizing these important Federal initiatives.

The Congress has invested significant dollars in this program over the last 20 years, and in return for that investment, what has resulted is an unprecedented network, a distribution network, of over 1,400 outlets to deliver small business services to all Americans. We think that there could be no better investment for any small business services than in utilizing the distribution network that Congress has already generated.

I will end my remarks with that, and I would be happy to answer any questions that you may have about our program.

[Mr. McCutchen's statement may be found in the appendix.]

Chairman TALENT. Thank you, Woody, Mr. McCutchen.

And our last witness is Caroline Hayashi, the Association for Enterprise Opportunity. Appreciate your patience; proceed.

STATEMENT OF CAROLINE HAYASHI, ASSOCIATION FOR ENTERPRISE OPPORTUNITY

Ms. HAYASHI. I would like to thank the chairman of the members of the House Small Business Committee for providing me with the opportunity to testify before you today.

My name is Caroline, and I am a member of the Association for Enterprise Opportunity, or AEO, and I am also the program director of the ECDC Enterprise Development Group in Arlington, Virginia. My views today represent AEO's views as well as those of my organization and the Association of Women's Business Centers.

AEO was founded in 1991. It is a national organization of organizations committed to microenterprise development. They provide over 490 organizational members with a forum, information, and a voice to promote enterprise opportunity for people and communities with limited access to economic resources. AEO members represent many SBA microloan intermediaries as well as Women Business Centers.

We all know that small businesses are the backbone of the U.S. economy. According to the Small Business Administration's Office of Advocacy, small business accounts for 53 percent of all jobs. What I am here to talk to you about today is the growing importance of the smallest firms within that group of small businesses. These are microenterprises employing less than five employees. Despite this critical role, many microentrepreneurs have trouble accessing management assistance and the capital they need to grow and start their businesses. Microenterprise development organizations are there to provide these resources to this growing market.

Over the past decade, the microenterprise development sector has grown rapidly, reaching over 55,000 entrepreneurs in 1997. Yet the demand for microenterprise services far exceeds the limited resources of the field.

Largely through the loan and grant funds from the SBA, the ECDC Enterprise Development Group has provided over 150 in the past 4 years to small businesses, totaling over $1.6 million. It has created 320 jobs and provided management assistance to over 2,500 entrepreneurs, and I would like to add out of all those individuals served that over 85 percent of those individuals were minorities, over 95 percent were low- to moderate- income individuals, and over 50 percent were women. So, again, as Mr. McCutchen noted, when we are talking about new markets, in terms of microenterprise organizations and who we serve, we are serving the new market.

Chairman TALENT. When you talk about—excuse me——

Ms. HAYASHI. Yes.

Chairman TALENT. When you talk about the ECDC——

Ms. HAYASHI. Yes.

Chairman TALENT [continuing]. Now, help me a little bit. That is the Association of Micro——

Ms. HAYASHI. AEO is the Association of Enterprise Opportunity, which is the national association of Microenterprise organizations of which we are a member.

Chairman TALENT. Okay.

Ms. HAYASHI. And I am actually the director of the ECDC Enterprise Development Group, which is a non-profit organization based on Arlington, Virginia which provides direct microenterprise services.

Chairman TALENT. Okay. So, I am trying to get a handle on how significant that $150 million figure is. You are one microlending intermediary.

Ms. HAYASHI. We are one microlending institution that serves the Washington, D.C. metropolitan area.

Chairman TALENT. I want to be clear. So, when you are talking about an Enterprise Development Group, that is a plural group, but you are one micro——

Ms. HAYASHI. Yes, we are one organization, one program.

Chairman TALENT. Because I thought the $150 million, actually, if that had been a number of microlenders, would have been kind of a small figure over 4 years.

Ms. HAYASHI. Yes, it would be very small. Actually, there is another number there of, a national number, 55,000 entrepreneurs being served in 1997——

Chairman TALENT. Yes, a little more like it.

Ms. HAYASHI [continuing]. Which is more like it, yes.

Chairman TALENT. Okay, thank you.

Ms. HAYASHI. Sure.

ECDC assists businesses that don't have access to capital and other business resources elsewhere. Although these loans are very uneconomical for non-profits to provide, these businesses promote economic self-sufficiency through the income and jobs they create and promote local economic development through the goods and services they provide. They also help keep individuals off of welfare and help build the local tax base.

I would like to give you an example of an entrepreneur that demonstrates the kind of impact that these kinds of small business can have on the owner as well as the community. Ms. Kyung Hee Park is a 40-year-old woman who 5 years ago found herself living in a homeless shelter with her two small children. She found the opportunity through an acquaintance to start a siding and flooring business. After the first year in business, when the company did not made a profit, her partner gave up his portion of the business. However, she decided to continue the business to try to make a better life for her and her children.

Two years ago, Ms. Park came to ECDC to get a loan to expand her business. Ms. Park had approached over 20 other financial institutions and was turned down partially because of credit problems she experienced while living in the homeless shelter. Since that loan 2 years ago, she has experienced more than 500 percent. She went from hiring 5 contractual employees to more than 20 full-time employees. She went from doing small residential jobs to obtaining large-scale financial contracts from companies such as U-Haul and has received a sub-contract for a 90-unit housing complex through the U.S. Department of Housing and Urban Development.

SBA has been a critical resource partner for ECDC. ECDC has $1.5 million in loan funds from the SBA, which constitutes approximately half of our capital pool.

Chairman TALENT. Ms. Hayashi, how many of—I was going to ask you, actually, to give us a particular example, so I am glad you did on your own. Is that typical? I mean, somebody—here, she had a working business up and going.

Ms. HAYASHI. Yes.

Chairman TALENT. But because her paper, in essence, wasn't good because when she had that difficulty in her life her credit went bad, and so the bank—she didn't even get through the front door of the bank, right?

Ms. HAYASHI. No, she is actually a very tenacious woman, so she did actually approach 20 other financial institutions, which not a lot of people do either. But, yes, was pretty much immediately turned away by——

Chairman TALENT. So, of the 150 loans that your group has given out, how many of them are situations where the person can't get through the front door because of a paper problem? In other words, you had a credit—I assume that the bank officer looks at this, "Wait a minute. You mean to tell me you have had a bankruptcy or this credit report is bad on you. Forget it. We are not even talking to you." Is that——

Ms. HAYASHI. Is that common?

Chairman TALENT. Yes.

Ms. HAYASHI. Very common, yes. A lot of the clients we serve either have had credit problems in the past because of this kind of life difficulty or we also have a surprising number of clients who do not have any credit history because we also serve a number of immigrants.

Chairman TALENT. Okay.

Ms. HAYASHI. And no credit, as we all know here in the U.S., is considered to be pretty much the same as bad credit.

Chairman TALENT. Yes, because you haven't had a history of credit.

Ms. HAYASHI. Exactly.

Chairman TALENT. So, the bank never even gets into performance of the business in the past or profit-loss statements or the rest of it, because they don't even get through the front door.

Ms. HAYASHI. Pretty much not. In some cases where they are able to get to a certain level, the business itself would probably not be able to get funded through a bank anyway regardless of the credit because of, for example, being a start-up, being too young of a business.

For instance, in Kyung Hee Park's case, although her business was a going concern, it did not have sufficient good credit history banks look at in order to take a risk of giving her a loan.

Chairman TALENT. Would these folks be in a situation where 50 years ago if they were in a small town what you do for them is what the local banker might have done given—it is an overused term—but a character loan?

Ms. HAYASHI. Exactly. In fact, I was just speaking to someone in my office about this who remembers being on a family farm and having that kind of bank there where the manager knew everybody in the town, and, yes, would give loans based upon the fact that they knew who they were, and they knew they would pay back.

Chairman TALENT. Yes, you mention George Bailey. Hey, I am the one who brings up old movies in this hearing.

Ms. HAYASHI. That is quite a good analogy, yes.

Chairman TALENT. I would say it is very applicable, isn't it?

Ms. HAYASHI. Yes, very good analogy.

Chairman TALENT. And often those individuals may end up being better credit risks, because they don't have—it is not like if they fail they are going to get another shot at it.

Ms. HAYASHI. That is exactly what we found is this is sort of we are working with individuals who had had a tough break in life, things have happened to them, and this is sort of like a second chance or in the case of immigrants sort of like of first chance type of loan program. And we have found in our program that these individuals are normally very good credit risks. We have——

Chairman TALENT. Let me ask—jump in, because we are going to have to run, unfortunately.

Ms. HAYASHI. Sure.

Chairman TALENT. So, I wrap up, because I don't think I will, unless the gentlelady wants me to, I don't think I will bring everybody back. Are you allowed to loan to ex-convicts? And I don't ask this to trap you. I think——

Ms. HAYASHI. I think we are allowed to.

Chairman TALENT. But do you very often?

Ms. HAYASHI. Not that I know of.

Chairman TALENT. You don't.

Ms. HAYASHI. We don't——

Chairman TALENT. That is another set of people who——

Ms. HAYASHI. We don't necessarily ask—we don't ask that question in our application process, but we usually get to know quite a bit about the person's life through the process.

Chairman TALENT. Okay. I may go into that a little bit more through staff.

All right. Well, go ahead and finish up.

Ms. HAYASHI. Okay. I just wanted to quickly outline five recommendations that AEO has based upon the experience of its membership of the SBA Microloan Program.

First, we would recommend that we give successful State programs a better chance to access assistance. AEO believes that States with successful or capable microlending intermediaries should not be limited by an arbitrary formula which regulates how much funding is available State-by-State. By eliminating this formula, we believe that the best programs, serving the most people, will be able to access assistance based on need and demand and not on geography.

Second, AEO recommends reducing confusing interest rate regulations. It is often confusing, both to program participants, as well as to the SBA, to administer different interest rates for different loans, which are tied to the 5-year Treasury bill interest rate. SBA should allow for a singular interest rate buy down for all intermediaries.

Third, AEO recommends that you let local programs determine the best forms of technical assistance. We think that it is duplicative and unnecessary for the SBA to proscribe how much technical assistance is available before a loan and after one. This type of micromanagement restricts program flexibility.

Chairman TALENT. You know why I bet that happens, because we had a discussion after the first panel up here about it. Everybody who gets into this field understands how important technical assistance is.

Ms. HAYASHI. Yes.

Chairman TALENT. None of us are comfortable that we have a handle on what it really is, much less that we can have any kind of accountability for it.

Ms. HAYASHI. Sure.

Chairman TALENT. So, we are in sort of a situation where we appropriate more money, we know how much—but we are also in the back of our minds afraid that somebody will mess up someplace and there will be some 20/20 program, and then we will all be hung by our thumbs for the thing.

Ms. HAYASHI. Yes.

Chairman TALENT. So, I would love to get a working group of people together to try and get a better handle on what is working, what isn't working, how we do this. Because it would be great—I mean, you are absolutely correct. Really, we ought to be letting the microlenders have greater control of what kinds of technical—but, you see, the fear from this standpoint is what is the money being spent on, which is a legitimate issue.

Ms. HAYASHI. If I can just speak to that for quickly. As you said, technical assistance is critical, and as you can see from the written testimony, for instance, in ACDC's case, we have maintained a less than 5 percent default rate, which is quite incredible considering the clientele that we are dealing with. And the way that we do that is through what we are broadly calling technical assistance, which is basically personal one-on-one business management—anything from business management assistance to personal problem assistance that they need in order to make their businesses successful.

Chairman TALENT. All we need, though, is one intermediary that uses the technical assistance to fly somebody to Paris for some seminar. And, look, I am not saying this happens, okay? I am saying if you put yourself—you are volunteering for that, I can imagine.

So, really, if you all would understand the perspective we have to come from up here and find ways of putting some kind of accountability measures in there that is consistent with the flexibility for you that you need, then we have solved the problem.

If you were sitting up here, what would you put in the law to make sure that you have some accountability while giving the flexibility you want? And I am very interested. We have got an reauthorization bill coming up. I am very interested in this, so go to work and let us know.

Ms. HAYASHI. AEO is very interested in actually having standardized, I guess, measures for the field, and perhaps that could be used, worked into the process to have more accountability in terms of technical process.

Chairman TALENT. At least begin the process, if you would, and I am going to—because we are going to have to—do you have a question you want to submit?

Ms. VELAZQUEZ. No. I will submit.

Chairman TALENT. All right. Can you finish up in a minute.

Ms. HAYASHI. I just want to—there are just two more recommendations that AEO has. One is to raise the loan cap to represent the increases in the cost of doing business. When the initial $25,000 maximum loan was set in 1991, as we all know, inflation has since eroded that cap, and we would like the SBA to look at raising that cap to reflect the cost of living increases.

Chairman TALENT. What should it be at?

Ms. HAYASHI. I don't know if AEO has a specific amount in mind right at this time.

Chairman TALENT. You give me a number, I was going to say okay. [Laughter.]

Ms. HAYASHI. Someone saying to say $40,000.

All right, the last recommendation is encourage greater cooperation among microenterprise Programs. We would also like Congress to lift the maximum allowable loan in joint ventures so that microenterprises can pair with other organizations to help to expand their businesses beyond the microenterprise stage.

Chairman TALENT. Ms. Velazquez said 60.

Ms. HAYASHI. Okay, great. [Laughter.]

Chairman TALENT. Eighty, all right.

Ms. HAYASHI. That sounds good.

[Ms. Hayashi's statement may be found in the appendix.]

Chairman TALENT. We have got 4 minutes, all right.

Thank you, Ms. Hayashi. I am sorry we were getting a little punchy there at the end, but we will certainly take your recommendations under advisement.

I appreciate everybody coming. I think I have done the house keeping details.

The hearing is adjourned.

[The statement of the Bond Market Association is located on page 110.]

[Whereupon, at 2:05 p.m., the Committee was adjourned.]

House Committee on Small Business
"Reauthorization of the SBA and the Fiscal Year 2001 Budget Request"
March 1, 2000
Opening Statement of Chairman Jim Talent

Good morning,

Today the Committee is meeting to conduct its annual ritual of considering the Administration's request for the SBA budget. We are also going to consider our triennial ritual of reauthorization of the SBA's programs. I am hoping to save the Members a little time by combining the two exercises.

I want to start by saying that, in general, I'm pleased with the budget submission for 2001, which means that the hearing this year will, as far as I am concerned, have a happier tone than in years past.

The SBA's budget request for 2001 is 1.06 billion dollars. This is a large increase over the current year's funding - approximately 330 million. However, to be fair, a large portion of this is disaster loan funding. Thankfully, the 2001 request for the disaster loan program is straightforward and adequate. This relieves us of a serious bone of contention from past years' budgets.

SBA's request for financial programs is also generally good. It requests 332 million dollars in new subsidy budget authority, a 65 million dollar increase over the 2000 request. Of this request 132 million dollars is for administrative expenses to operate the financial programs. That represents a small increase over the 2000 request but a significant, 38 million dollar increase over previous appropriations.

The request for the 7(a) loan program is 142 million dollars to provide $11.5 billion in overall loans. I believe this is a reasonable request, as SBA forecasting is usually accurate. I am more concerned about this year's loan availability and I'll be interested in hearing from the Administrator about her projections for this year.

The 504 program again requires no subsidy and I believe the committee joins me in supporting the authority to make the full authorized amount of loans under this program available. However, like other Members I would like to hear about the future of the program and its subsidy rate.

The SBIC program also receives an adequate request and one the Committee supported in its letter to the committee on the budget. If fully funded the SBIC program will be able to make over 2 billion dollars of venture capital available to small businesses in fiscal year 2001.

The microloan program is targeted for the most significant increase for 2001. It will jump from 29 million dollars to 60 million dollars in microloans. While there is no shortage of support for this program, and the real dollar increase is only 2.5 million dollars there may be some question about the ability to expand that quickly.

On the technical assistance side of the SBA's budget request there is both good and bad news. The good news is the Small Business development center program receives an adequate though not ample request of 85 million dollars. There is also a 3 million dollar request for Native American SBDCs, an excellent proposal.

The bad news is that there is an increase in unauthorized program funding that would take too much time to list here, and at the same time an elimination of funding for authorized programs, like the Drug Free Workplace program which the Congress approved overwhelmingly three years ago.

Finally, let me state my support for the request for the Office of Inspector General. This committee has long supported improved funding for that office. The only comment I might make is that the increase should be divided between audit and investigative functions.

I want to thank our witnesses Administrator Alvarez, Tony Wilkinson of NAGGL; Lee Mercer from NADCO; John Geigel from NADCO; Woody McCutchen from the Small Business Development Centers; and Ms. Caroline Hayashi from the Center for Enterprise Opportunity representing the microlending community. We will have two panels: First, Administrator Alvarez and; Second, the panel of witnesses from the small business organizations.

Before we begin hearing testimony I will turn to my colleague Ms. Velazquez for any statement she wishes to make.

JAMES M. TALENT, MISSOURI
CHAIRMAN

NYDIA M. VELÁZQUEZ, NEW YORK

Congress of the United States

House of Representatives

106th Congress

Committee on Small Business

2361 Rayburn House Office Building
Washington, DC 20515–0515

Statement from the Honorable Nydia M. Velázquez
Hearing on SBA's Loan System Modernization
March 1, 2000

Thank you Mr. Chairman. I would like to thank the Administrator and commend her for presenting an ambitious budget request that clearly reflects the Administration's desire and ongoing efforts to help this nation's small businesses.

As we are all aware, this country is experiencing one of the greatest economic booms in modern history. This unprecedented growth has been fueled by the flourish of small businesses throughout this country.

Today, small businesses make up 51 percent of the Gross Domestic Product and contribute 47 percent of all sales in this country. In fact, According to the Department of Labor and the Department of Commerce, small-business-dominated industries produced an estimated 64 percent of the 2.5 million new jobs created during 1996.

With this in mind, I believe it is critical at this historic juncture to assess where we are; how we got here; and where we need to go, to continue to have a strong and vibrant small business community.

We have gotten where we are today based on the solid support of such established programs as 7a, 504, 8a, Microloan, SBIC and SBIR. These programs through access to capital, opening doors for minority businesses, and technology development are the bedrock that has helped this nation's small businesses lead the way into the 21st Century.

The Administration's budget presents a good mix of new and existing programs. We are making improvements to the SBIR program through Phase III grants that will enable small technology firms to be more competitive in the marketplace. One priority for Democrats has been making small loans more accessible to businesses.

This can be done by increasing the guarantee on loans of under $150,000 to 90 percent, offering small businesses the economic chance they need to exist.

Innovative new programs that show consideration for future businesses have been unveiled in this Budget like PRIME, which helps low income communities and the new veterans' program, which will help those who have served this country.

Most importantly though, the Administration attempts to address what I believe is the most pressing issue facing our nation: the widening gap between those who have prospered from our current economic boom, and those that have been left behind. For example, in my district of Brooklyn, the unemployment rate is still 10 percent.

These are good hard working people who today cannot afford to start their own businesses but who want and deserve an opportunity for economic prosperity.

That is exactly what the proposed New Markets Venture Capital Company legislation will do. By providing equity investment and technical assistance, businesses will have an easier time obtaining capital or expanding their businesses in poor or underdeveloped areas throughout the country. This is not only the right thing to do but it makes good business sense.

This Committee has an opportunity to make changes, new changes that will benefit small businesses and those who *are* looking for economic opportunity in starting their own.

Today's hearing will assist us in making the kinds of economic decisions that not only will help close that widening gap, but will hopefully keep us on the right economic track for continued prosperity in the future.

I look forward to reviewing this Budget in greater detail and determining what changes need to be made to better enhance small businesses.

Thank you ladies and gentlemen who are here to testify before the Committee today.

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, DC 20416

STATEMENT OF

AIDA ALVAREZ

ADMINISTRATOR

U.S. SMALL BUSINESS ADMINISTRATION

SBA'S FISCAL YEAR 2001 BUDGET REQUEST
AND REAUTHORIZATION

BEFORE THE

SMALL BUSINESS COMMITTEE

UNITED STATES
HOUSE OF REPRESENTATIVES

MARCH 1, 2000

Mr. Chairman, Ranking Member Velazquez, and Members of the Committee, thank you for inviting me here today. I am very proud to present the U.S. Small Business Administration's (SBA) budget request for Fiscal Year 2001.

For small businesses and for the SBA, this is a great budget. It represents an unprecedented investment in the talent, drive, and entrepreneurial spirit of Americans. It recognizes the vital role small business plays in our economic growth and vitality. And, it delivers results at a fiscally prudent cost to the taxpayers.

A Decade of Success

There are now more than 25 million small businesses in the United States, five million more than in 1990, and the most ever in the United States.

Over the last decade, business ownership has grown even more rapidly for Hispanics, African-Americans, Asians, and for women. Hispanic-owned firms have increased 232 percent, African American-owned firms by 108 percent, and Asian-American and Pacific Islander-owned firms by 180 percent.

The number of women-owned firms has almost doubled to an estimated 8.5 million in the last 10 years. Women now own about one-third of all firms and employ 24 million people. These companies generated $3.1 trillion in revenue in 1997, more than triple the amount from a decade earlier.

And, small firms remain the job creators – they have produced a majority of the 20 million new jobs created between 1993 and 1998.

It has been a period of astounding growth and change. And throughout, SBA, working with this committee, has adapted its products and services to contribute to the overall growth and vibrancy of the small business sector. Further, we have focused our help more clearly on those who need it the most. Our training, financing, technical assistance, and contracting opportunity programs are tools used to help build economic development in distressed inner city and rural communities.

SBA partners with the private sector to help fill the gaps that prevent people from owning their own business and that impede our nation's overall economic progress. To succeed we must fill gaps in both financial access and skills training, often at the same time.

Our lending policies have facilitated a dramatic expansion in the scope of private lending to small businesses. Programs like SBA Express, Low Doc, and Preferred 7(a) Lenders have fueled the growth by giving our lending partners greater responsibility and by simplifying the loan approval process for smaller and non-traditional loans.

SBA guaranteed 50,000 loans in FY 1999—loans that would not have been made without our support. Approximately a third of our 7(a) loans in FY 1999 went to start-up firms less than 24 months old. That is filling a gap. Since 1992, we have doubled our lending to African-Americans and Hispanic-Americans, while tripling our lending to women.

We also play a significant role in the availability of equity capital. In 1999, Small Business Investment Companies (SBICs) averaged less than $1 million per investment, while other venture capital firms averaged $6.2 million. In 1999, SBICs accounted for 53 percent of all institutional venture capital transactions in the United States.

In the area of procurement, small businesses achieved a 22.4 percent share of total Federal procurement. We were pleased to launch the Historically Underutilized Business Zone (HUBZone) Program. I am happy to report that nearly 900 businesses are now qualified as HUBZone firms.

SBA's Office of Advocacy worked to show agencies how their regulations could accomplish their policy objectives without placing an undue burden on small businesses. The Office's efforts save small businesses literally billions of dollars. Our budget proposes increasing funding for Advocacy's research and database to $1.5 million, $400,000 more than FY 2000.

To assist families and businesses hit by disasters, we approved 36,000 loans for a little more than $900 million in 1999. Our loans enabled firms to continue their business and retain 35,000 jobs.

Mr. Chairman, preparing to testify before you today gave me the opportunity to review the truly enormous changes that have taken place at the SBA. SBA is a great story of reinvention, about which this committee should be very proud. Now, we must continue to build on successful strategies and successes of the past to help small businesses meet the challenges of the future.

SBA requests funding of $1.06 billion for FY 2001. This budget will allow us to guarantee a record level of small business loans, finance record levels of venture capital, and support record levels of business development, technical assistance, and innovation. It gives us the resources to help create jobs and economic development in places the current economic expansion hasn't yet reached. It supports our continuing efforts to transform the SBA into a 21st century leading edge institution.

Finally, it fully supports our commitment to assist families and businesses recently hit by disasters. Mr. Chairman, we request full funding to allow us to provide $871 million in low cost loans for disaster victims.

New Markets

In his State of the Union address, President Clinton repeated his belief that more must be done to extend the benefits of today's economy to our inner cities, poor rural areas, and Native American reservations. He thanked Speaker Hastert for his bipartisan effort to achieve this common goal. We hope we all can come to an agreement soon that includes our New Markets Venture Capital proposal so we can start to put our FY 2000 appropriation to work. Mr. Chairman and Ranking Member Velazquez, my staff and I are pleased to be working with you to make this happen.

This budget includes several proposals designed to make investment capital available to newer, smaller firms.

We request $21.6 million in budget authority to support a $150 million program level, and an additional $30 million for technical assistance for the New Markets Venture Capital program. Smaller size equity investment plus technical assistance are key to the long-term success of New Markets firms.

The cost of the program, which we calculated using the most conservative assumptions, will go down as we develop experience with the program. The long-term benefits are impressive.

Right now, there are virtually no institutional sources of equity-type capital in these distressed communities. Nationwide, the community development venture capital industry consists of essentially 25 firms with about $157 million under management. Only 14 of these funds are capitalized at $5 million or more—the absolute minimum for economic viability.

Our own analysis of these community development venture capital companies indicates that one direct job is created for each $10,000-$15,000 equity investment. On this basis, $51.7 million should generate between 13,300 and 20,000 direct jobs at a cost of between $2,600 and $4,000 each. If the indirect jobs are included, the cost is even less. We believe that this investment in New Markets will ultimately pay off in a big way.

SBA is requesting funding for other New Markets initiatives as well.

At the close of the last session of Congress you passed, and the President signed, a law establishing the Program for Investment in Micro-Entrepreneurs (PRIME). This program provides much needed technical assistance to very low-income entrepreneurs to improve their capacity to succeed in business. We request $15 million in budget authority for PRIME. In addition to serving the micro-enterprise industry generally, PRIME will perfectly complement our overall micro strategy.

In addition, we are making every effort to expand the reach of our existing Microloan program. We request $5.37 million to support $60 million in Microloans, along with $45 million for Microloan technical assistance.

We request $6.6 million for SBA's BusinessLINC program, which encourages large businesses to work with small business owners as technical advisors and mentors—especially in America's rural areas and inner cities.

We began accepting HUBZone applications last March. As demand increased we added staff and are now up to nearly 900 certified HUBZone companies in 47 states. We request $5 million to integrate this program into our field structure, and broaden our outreach and oversight efforts to help this program meet its full potential. This compares to $2 million appropriated in FY 2000.

To better serve Native American communities and to honor the federal government's trust responsibility to tribes, the President's budget overall includes an increase of $1.2 billion over FY 2000 for key new and existing programs assisting Native Americans and Indian reservations.

Mr. Chairman, one of every three Native Americans live in poverty. On some reservations, between 40 percent and 60 percent of the population is unemployed. Fifty-three percent of Indian homes on reservations do not have a telephone.

We want to tap into the entrepreneurial drive within the Native American community. SBA's budget proposes $5.75 million ($3 million for Native American SBDCs, $1.25 million for reservation-based BusinessLINC, and $1.5 million for TBICs) to provide access to business development assistance that recognizes the cultural differences and specific needs of this country's Native American entrepreneurs.

Access to Capital

The SBA is filling critical gaps in the marketplace and helping those who have not shared in the tremendous economic growth of the past several years. Smaller loans are out there – but they are still hard to get. If you are from a distressed urban or rural area, if your business is newer, if you are smaller, if you lack sufficient equity, or an established track record, you are more likely to be turned down by a commercial lender. This is the gap that we fill and the unique value that we bring to businesses.

We request $274 million to deliver more than $18 billion of credit, venture capital and technical assistance. The $18 billion compares to $16 billion in FY 2000. Our request includes:

- an $11.5 billion program level for the 7(a) loan program, up from $9.8 billion this year;
- a $3.75 billion program level for 504 loans—and we propose to lower the guarantee fee for the fourth year in a row.

To encourage more lenders to offer loans in smaller amounts, SBA proposes to raise the guaranty for 7(a) loans of $150,000 and less to 90 percent. Relatively high transaction costs and the loss of smaller rural and community lenders is shrinking the financing options available to smaller businesses. Our 90 percent guaranty will encourage more institutions to lend using our 7(a) product, making capital more available at a more competitive price, and expanding financing options for small business owners. We also propose to simplify the guaranty fee structure for all loans.

We request $26.2 million in budget authority to support $2.5 billion in venture capital in the Small Business Investment Company program. We expect this investment will attract an additional $1.25 billion in private capital to the smaller and newer end of the venture capital investment spectrum. With the $3.75 billion in new SBA leveraged funding, plus their on-hand private capital, we estimate the SBICs will be able to make $4.5 billion in investments in FY 2001.

I am pleased to report that since the SBIC participating security program's inception in 1995, the SBICs have returned over $131 million to the U.S. Treasury as the taxpayers' share of their profits.

To appreciate SBA's success in assisting small business, we need to step back and look at the bigger picture. Since 1992 SBA has backed more than $71 billion in small business loans and venture capital. That's more than in the previous 25 years combined!

Mr. Chairman, we plan to send our legislative package to you shortly and we look forward to working with you in the coming year to enact these changes.

Safety and Soundness

Coupled with our desire to sustain unprecedented growth and to penetrate new markets, Mr. Chairman, is our solid commitment to maintaining the financial safety and soundness of our portfolio. We are a financial institution with more than $50 billion in our portfolio. Just like financial institutions in the private sector we have the fiduciary responsibility to make our lending decisions wisely and guard our current investments carefully. Anything else would be a disservice to our borrowers and lenders, as well as the Federal taxpayer.

In FY 1999, Mr. Chairman, we instituted—for the first time—a safety and soundness examination program for the Agency's Small Business Lending Companies and examined all 14. We expect to complete our FY 2000 reviews in September. We established the Office of Lender Oversight and a Risk Management Committee. We completed our first full cycle of reviews for participants in the Agency's Preferred Lender Program (PLP). We expect to complete FY 2000 reviews by April.

In addition, we request $14.3 million to fund our Inspector General, to provide the necessary review, audit, and oversight of SBA's programs and services to the small business community. This compares to $11.5 million appropriated for FY 2000. The increase will allow the Inspector General to oversee areas identified as high priority by the Agency and Congress, such as loan monitoring and lender oversight.

Access to Training and Technical Assistance

SBA also fills gaps in the area of training and technical assistance, reaching out to new and non-traditional markets through our Small Business Development Centers, Service Corps of Retired Executives (SCORE) Women's Business Centers, One-Stop Capital shops, Tribal Business Information Centers (TBICs), and U.S. Export Assistance Centers. Our small business counseling and technical assistance programs provided help to more than a million entrepreneurs in FY 1999 alone—many of them are also loan customers.

For FY 2001, we propose full funding of $88 million for Small Business Development Centers (SBDCs), including $3 million to fund an SBDC network in Native American communities. In addition, we are pleased to be working with the SBDCs in considering ways to grow their non-government resources and extend their reach to even more small businesses.

To upgrade SCORE's computer network, allowing SCORE counselors to communicate better among themselves and with the SBA, we propose funding of $5 million—an increase of $1.5 million from this year.

SBA's Women's Business Centers have more than tripled in three years, going from 18 funded centers to 59 (including 25 new WBC's in FY

1999.) The budget includes $12 million, up from $9 million in FY 2000, to expand our network of Women's Business Centers even further. The request would widen our nationwide network to more than 80 sites. It is our hope to have at least one center in each state.

SBA requests $10 million to maintain our existing One Stop Capital Shops and to open new ones in empowerment zones across the country. These community-based outlets provide hands-on assistance to help businesses start, grow, and provide employment in these distressed areas.

In addition, this year our budget proposes $4 million for our veterans programs, compared to $615,000 appropriated in FY 2000. We owe our veterans the best service possible when they are interested in starting or expanding a small business. Our request will fund research and outreach efforts to help us better tailor our products to the particular needs of the veterans' community. It will also fund the National Veterans' Business Development Corporation, which was created by Congress last year to help improve access to small business development training and counseling for our Nation's veterans.

Promoting Procurement for Small Business

The Federal Government spends nearly $200 billion for goods and services each year. This is a tremendous marketplace for America's small businesses. SBA works with the major procuring departments to ensure that small businesses receive 23 percent of these Federal contracting dollars.

Mr. Chairman, it has become increasingly difficult to maintain the level of contracting opportunities for small businesses. Over the past 10 years we have seen agencies increasingly rely on contract bundling. Unfortunately, bundling tends to limit procurement opportunities available to small businesses.

To counter the effects of contract bundling we have been pleased to work with this committee on implementing the contract bundling provisions of the 1997 Small Business Reauthorization Act. We plan to issue a final rule later this year that will provide clear guidelines and procedures that we believe will curtail agencies practice of bundling contract requirements.

Small businesses, particularly minority-owned small businesses, often do not receive a fair share of government contracts. To help them become more competitive we are requesting $5 million for the 7(j) program. This program provides technical assistance and executive training to 8(a) firms and small businesses in areas of high unemployment or low-income. If we are to develop these minority-owned firms, we must provide targeted assistance to help them grow and build a broad-based business selling to both the public and private sectors.

Our research indicates that even after the firms in our Small Business Innovation Research Program have fully developed their products, they still lack the venture capital they need to market and fully commercialize those high quality technologies. Commercial venture funds typically are not interested in the types of investment opportunities SBIR firms present at that stage, referred to as phase III, of their development. We request $15 million in FY 2001 to fund the first-year of a three-year SBIR Phase III matching grant pilot program, designed to promote commercialization of the research and development (R&D) efforts by small high technology firms.

Modernization

SBA's workforce and the way we deliver programs have changed dramatically in the past decade, too. Since 1990, our loan portfolio has grown from $17.5 billion to about $50 billion. At the same time the number of our employees has decreased 22 percent.

We are devoting significant energy and resources toward improving our capacity to monitor our loan portfolio. SBA is building an early warning system of indicators and graduated enforcement remedies. We will soon have a new system in place that will enable us to better identify and manage portfolio risk and integrate SBA's system with those of private sector lenders.

Working closely with the Congress, SBA has recognized where the private sector could perform our tasks more efficiently, and has contracted out or delegated those activities. SBA is delegating greater authority than ever before to its lending partners. This transition permits greater use of staff for community outreach and greater attention to more complicated loan matters. Most importantly, according to our auditors, we are making the transition in a manner that is financially safe and sound. SBA received a clean opinion in its FY 1998 financial audit report, the highest rating an entity can receive. This was the third year in a row SBA attained this rating. As you know we completed our first asset sale last fall and enjoyed great success. We realized an estimated $90 million premium over what SBA would have received had we held the loans to maturity. We plan a second sale in FY 2000 and are strategizing how to continue in FY 2001.

We are emphasizing the importance of improved internal controls and program oversight. We are upgrading and modernizing our information systems, offering every small firm electronic access to our products and services to extend our outreach and offer more customer-driven assistance. And we are transitioning our people to meet the challenges of the new knowledge-based economy.

We have laid out an aggressive agenda to improve our internal management. We request $13 million for systems modernization to improve our lender oversight, risk management, and program evaluation activities; $7 million for information technology infrastructure support; and $4 million to train and transition our workforce.

E-Commerce

SBA was among the first government agencies to create an on line presence. In the last seven years we have grown from no businesses served on the Internet to over 6 million small businesses served each week. We expect that number to double this year.

SBA's current activities include:

- Online Education, Training, and Counseling. The accessibility and affordability of the Internet offer businesses online counseling, distance learning, online classrooms, and web-based tutorials, e.g., SBA classroom, SCORE online.

- Access to Networks and Matchmaking. Increasingly, the new SBA is taking on the role of creating markets, fixing market imperfections where possible, and/or providing a platform for "buyers and suppliers" to connect and transcend the boundaries of time and distance. Some call this function electronic brokering, e.g., ACE-Net, PRO-Net, TradeNet, Tech-Net, HUBZones, Sub-Net, TM-Online, NewMarkets.

- One-Stop-On-Line-Shop for Government Information. SBA is providing anytime, anyplace access to Government information and services through its own web site and is developing and sponsoring cross-agency gateways and portals, e.g., *U.S. Business Advisor*, TradeNet's *Export Advisor*, Women's Online Business Center.

This unique movement has leveled the playing field for unprecedented numbers of entrepreneurs from every background who seek to own their own business. But as always in business, this potential is accompanied by risk. SBA's small business customers cannot afford to overlook or fail to take advantage of the opportunities created by new technologies. And if technology is going to revolutionize the way small companies do business, then SBA must increase its own digital dexterity and focus its assistance on helping firms compete in the new economy.

To respond, we are creating an electronic SBA, one that can serve as an example for bridging the "digital divide" and help small firms take advantage of the technological revolution.

The budget includes $5 million to ensure that we provide more of our services electronically, and to ensure that all small businesses are able to participate in the opportunities created by e-commerce. Building on the success of our Y2K outreach initiative, where 1,300 workshops were attended by about 1.5 million small businesses, we will now work with the Department of Commerce and the Department of Agriculture to reach out to entrepreneurs looking to get on-line. For those who are on-line, we will expand our training, offering virtual classes on topics such as building a website, conducting e-commerce on the Internet, marketing your business on-line, bidding electronically and catalogue sales.

Conclusion

SBA's budget is a key element of the President's plan to maintain today's unprecedented economic expansion. The Agency is confident that our flagship programs and services—credit and capital, business development and technical assistance, and procurement assistance—are some of the best forms of Federal assistance to broaden access to small business opportunities, and help sustain our strong economy. These programs also make SBA even more vital in this Administration's strategic focus on new markets areas.

I look forward to working with you and the Committee toward the implementation of this budget.

The National Association of
Government Guaranteed
Lenders, Inc.

Statement

of

Anthony R. Wilkinson

President
and
Chief Executive Officer

of the

National Association of
Government Guaranteed Lenders, Inc.

before the

Committee on Small Business

United States House of Representatives

March 1, 2000

Good morning Mr. Chairman and Members of the Committee. My name is Tony Wilkinson and I am President and Chief Executive Officer of the National Association of Government Guaranteed Lenders, Inc, or NAGGL. NAGGL represents nearly 700 lenders and other program participants who make approximately 80 percent of the 7(a) loans guaranteed by the Small Business Administration. We thank you for holding this hearing today and requesting our input on SBA's budget and proposed authorization levels for the 7(a) program.

H.R. 2615

Before addressing this subject, may I thank the Committee for your expeditious consideration of this legislation last year and the House's overwhelming endorsement of it on the suspension calendar. I want to briefly mention one provision, pre-payment fees. As you are aware, it provides a prepayment fee on long-term loans with excessive prepayments in the first three years of the loan. We share your belief that this type of provision is necessary in order to avoid loss of fee income, income that could ultimately be replaced by the imposition of higher fees on future borrowers. As a matter of fairness, the cost burden caused by prepayments should be borne by those who choose to prepay, not by future program users.

The 2001 budget request confirms that we are incurring higher costs on the program due to prepayments. Specifically, the subsidy rate includes an increase of 11 basis points primarily as a result of an increase in the loss of fee income due to loan prepayments and Treasury earnings on these fees.

Please continue to support this provision when you go to conference with the Senate.

7(a) Budget and Authorizations

First, let me raise a problem with this year's budget. The current appropriation supports a year 2000 program level of approximately $9.8 billion net. We believe that loan demand, which historically is higher during the spring and summer months than in the winter, will be $10.5 billion net. We have discussed this shortfall with the Agency, but SBA has not announced its proposal to correct the problem. We would hope that they would do so very soon as the necessary corrective action becomes more acute the more time that passes.

Second is the 2001 request. We agree with SBA's request of $11.5 billion net, which is the amount of demand we estimate for next year.

Third, as to authorizations, we recommend that the Committee continue its past policy of providing three-year authorizations. Specifically, NAGGL recommends the following authorization levels in amounts of 7(a) loan guarantees:

- $14.5 billion in fiscal year 2001,
- $15.0 billion in fiscal year 2002, and
- $16.0 billion in fiscal year 2003.

We would note in this regard that NAGGL is recommending straight-lining the authorization level from the year 2000 to the year 2001 as Congress has already authorized a $14.5 billion program level for fiscal year 2000. We believe that these amounts are sufficiently above the current budget level to provide some flexibility to the Appropriations' Committee in future years should a change in the economy necessitate consideration of a higher level of loan guarantees without the necessity of the authorization being changed.

7(a) Program Performance

We were pleased that the President's Budget Request reported that the 7(a) program performance remains high: the recovery rate on liquidation of defaulted loans remains unchanged in 2001 at 60.6% while the default rate is projected to decrease slightly from 14.42% in 2000 to 14.29% next year. I am compelled to say, however, that NAGGL believes that the default rate is still materially overstated.

As part of the subsidy rate calculation, SBA each year looks back to see how the actual numbers compared with the projections and re-estimates or calculates the difference. As of last year, the costs were projected too high and resulted in a re-estimate that the Agency had collected $833 million more than was needed. The 2001 Budget Request reports more of the same: another $176 million excess.

In essence the 7(a) program is operating at a profit to the government under the current fee structure! It should not have any subsidy cost and fees should have been reduced rather than needing to appropriate money to pay for the program. The 7(a) program more than pays for itself, but the erroneous assumptions mandated by the Office of Management and Budget continue to prevail.

Subsidy Rate Floor

At this point I would request the Committee's indulgence in addressing a topic which we refer to as a subsidy rate floor.

In 1994, SBA began using a new subsidy rate model and in order to offset the model's projections of the cost of operating the 7(a) program, this Committee imposed a very substantial increase in 7(a) guarantee fees. Until this increase in fees was imposed by Public Law 94-306, borrowers paid a one-time fee of 2%. The new law retained that fee only on loans of up to $80,000. Larger loans incurred higher fees, some almost doubled:

- 3 percent on the first $250,000 guaranteed,
- 3.5 percent on the second $250,000 guaranteed, and
- 3.875% on amounts above $500,000.

In addition, an on-going fee of 50 basis points (0.5 percent per annum) of the outstanding loan balance was mandated to be paid by the lender for the life of the loan.

In recent years, the cost of the 7(a) program has fallen due to improved underwriting and program improvements. However, reductions in federal funding for the program offset all of the cost reductions; none of the savings were used to reduce or rescind any of the 1994 fee increases.

NAGGL believes that borrowers should receive some benefits from an improving program and that it is time to begin reducing fees. Accordingly, we propose establishing a 1.25% subsidy rate floor. If program performance continues to improve or if for any other reason the subsidy rate would fall, SBA should be directed to begin reducing fees in order to maintain the subsidy rate at not less than 1.25%.

Historically, this Committee has agreed that 7(a) loans benefit much more than the borrower (for example, employment and the economy) and thus has advocated federal support or money in order to support the 7(a) loan program. This policy, however, has eroded over the past five years and could disappear completely in the next year or two. We urge that the Committee re-examine this matter and if you continue to agree that the Government should support small business lending, legislate a floor so that the entire cost of the program will not be imposed on borrowers.

Thank you for the opportunity to appear today. We look forward to working with you on this and related legislation during the remaining months of this Congress.

NASBIC
America's Small Business Partners

Statement
of
Lee W. Mercer

National Association of
Small Business Investment Companies

Before The

United States House of Representatives
Committee on Small Business

March 1, 2000

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Mr. Chairman, Ms. Velázquez, and members of the Committee:

A. Introduction.

My name is Lee Mercer. I am President of the National Association of Small Business Investment Companies (NASBIC), the nonprofit association that has represented the SBIC industry since 1958, the year Congress passed the Small Business Investment Act establishing the SBIC program. NASBIC works with Congress to provide the information you need to draft legislation that governs the SBIC program and with SBA to help develop reasonable operating regulations. NASBIC also produces educational programs and publications designed to help SBIC managers and others in the venture capital industry gain the knowledge and skills they require to invest successfully in small private businesses. In this regard, NASBIC members also agree to adhere to a code of ethics and fair trade practices promulgated by NASBIC. Finally, NASBIC works with the news media and private sector information providers to help ensure that the information published about the SBIC program is as complete and accurate as possible.

B. NASBIC Supports the Administration's FY 2001 SBIC Budget.

On behalf of the SBIC industry, I appreciate the opportunity to offer our views on the SBIC portion of the FY 2001 budget that has been proposed by the Administration. We support the Administration's budget as we understand the same has been amended by the testimony of Small Business Administration Administrator Aida Alvarez. Our understanding is that the budget proposes making the following amounts available to SBICs in FY 2001 to augment their private capital for small business investment purposes:

- For Participating Securities: $2 billion at an appropriations cost of $26.2 million given the reduction in the Participating Security subsidy rate from 1.8% to 1.31%. That amount would be subject not only to the appropriation, but also to authorization of at least $2 billion in the SBIC program reauthorization legislation that this Committee will soon address. Our suggestions regarding authorization levels are set out below.
- For Debentures: an amount to set by the SBIC program authorization legislation referenced above since the Debenture subsidy rate continues to remain at zero. During FY 2000, the amount of Debenture leverage available is $800 million.

The amounts appear to be very reasonable given the recent growth of the SBIC program, particularly with respect to Participating Security SBICs and the amount of private capital they have brought into the program. Through February 23, 2000, Participating Security SBICs had approximately $2 billion in private capital under management, with $765 million of that amount invested in just the past 17 months. Outstanding leverage and leverage commitments equaled $2.4 billion as of February 23. Thus, for existing Participating Security SBICs to have access to at least two tiers of leverage—the basic program model—a total of $1.6 billion in new leverage would be required. We project that SBA will licensing at least 30 new Participating Security SBICs with $500 million in private capital during the balance of FY 2000 and all of FY 2001. That would indicate a maximum potential need for an additional $1 billion in leverage authority between now and the close of FY 2001. The additional $400 million proposed in the

Administration's budget is conservative given these projections, but is reasonable given that potential shortfall for SBICs licensed late in FY 2001 can be addressed in the FY 2002 budget.

C. NASBIC Suggested Reauthorization Levels.

Since the Debenture subsidy rate will remain at zero for FY 2001, the amount of Debenture leverage available in FY 2001 will be governed by the SBIC program reauthorization legislation that Congress must pass this year. This leads me to our suggestions for program authorization levels for Fiscal Years 2001 – 2003. They are set out below.

	FY 2001	FY 2002	FY 2003
Debentures:	$1.0 billion	$1.5 billion	$2.0 billion
Participating Securities:	$2.5 billion	$3.25 billion	$4.0 billion

The suggested growth in the Participating Security authorization levels is in keeping with the growth slope of the program for the past four years. The suggested levels for Debentures are cannot be justified alone by reference to current use of Debenture authority. Rather, we suggest the new levels for two reasons. First, last Spring Congress amended the Small Business Investment Act in a manner that for the first time will make debt investments that also involve royalty agreements attractive vehicles for SBIC investments in small businesses. SBA has yet to issue implementing regulations. However, when it does, we believe that thousands of businesses that heretofore would not have attracted SBIC financing will be able to do so. We urge SBA to issue its regulations soon.

The second reason for the suggested Debenture levels relates to a new "zero coupon" debenture that will be available from SBA in the near future. It is intended for use by SBICs investing in small businesses located in Low- and Moderate-Income (LMI) areas. With no interest due until at least five years, Debenture SBICs will be able to make many more equity investments than they can at present—subject to LMI regulation requirements. Since equity investing is the most popular form of SBIC investing at present, the potential exists for the new Debentures to stimulate renewed interest in Debenture leverage. Thus, the new authority and flexibility that will soon be available to Debenture SBICs leads us to suggest keeping authorization levels relatively high over the next three years.

D. NASBIC Legislative Proposals.

As this Committee considers reauthorization legislation, we also urge the consideration of four program proposals. Three proposals will bring program rules into balance with current operating norms in venture capital investing and reduce overhead time and expense at SBA. The forth would make permanent the authority of SBA to reduce fees paid by SBICs when subsidy rates fall below zero, as they will for the Debenture program in FY 2001. The proposals and their rationales are set out as attachments to this testimony.

E. SBIC Program Statistics.

In addition to our legislative proposals, I have attached a one-page recitation of some of the most important FY 1999 SBIC program statistics. Taken from SBA data, the statistics give the basic and most important facts with respect to the role of the SBIC program in supporting America's small businesses. The SBIC program is a model partnership between government and the private sector to meet a critical national requirement. It is an unqualified success in building small businesses. Congress has heard for years about how Apple, Intel, Federal Express, and Callaway Golf, to name but four well-known examples, received some of their early financing from SBICs. In fact, in Table 22 of its Fiscal Year 1999 SBIC Program statistical package, SBA lists 122 well-known companies that received early financing from SBICs. I have attached that list of companies to my testimony. However, a list tells only the result. It does not give the details of how a particular SBIC helped a particular small business flourish. NASBIC attempts to fill in some of that information for various small companies that have received SBIC financing. As we complete our research with respect to any company that has received SBIC financing, we post it in the "Success Stories" section of our Internet site at www.nasbic.org. We have developed 50 stories to date and encourage you to review them. They tell the real story of the SBIC program.

F. Conclusion.

In conclusion, the SBIC program is well conceived and producing the results that were intended by the legislation. This Committee and Congress have moved quickly and effectively in passing legislation that has improved the SBIC program and made it safer and sounder from the Government's perspective and more effective in providing capital to worthy small businesses. We believe the SBIC program is in the best overall shape of its history and we at NASBIC and the SBIC managers that NASBIC represents are proud to be part of it. The millions of jobs that have been created by the program over the years represent a return on investment that is the envy of all who have studied the program. We believe there is even more to be done in the future and the Administration's proposed FY 2001 budget set appropriate levels in that regard. We look forward to working with the Committee this year and in the years to come to ensure the SBIC program is always in the best position to attain its full potential.

NASBIC Proposed Amendments to the Small Business Investment Act

1. **Issue:** The definition of long-term as found in Section 102 of the Act.

   Proposal: Amend Section 103 of the Act by adding the following new definition:

   > (17) the term "long-term" when used in connection with private equity capital or loan funds invested in small-business concerns and smaller enterprises pursuant to this act shall mean any period of time equal to or greater than one calendar year.

   Rationale:

   - SBA has construed the term "long-term" as found in Section 102 of the Act to mean a period of time equal to a minimum of five years for all SBIC investments other than those made in "Disadvantage Businesses." For the latter, the minimum period is four years.

   - This interpretation is overly restrictive and does not allow SBICs and small businesses to fashion investment agreements that are flexible enough to meet the needs of both parties in accordance with the dictates of the commercial marketplace.

   - SBA's interpretation finds no counterpart in any other area of business commerce. To the contrary, Generally Accepted Accounting Principles (GAAP) define "long-term" as any period of time greater than one year in duration. Likewise, tax law defines "long-term" for capital gains purposes as a period greater than one year. The proposed amendment would make SBIC law consistent with GAAP and tax law.

   - SBA has recognized that its position is overly restrictive by allowing SBICs that invest in small businesses located in Low and Moderate Income (LMI) areas to structure their investments for periods equal to or greater than one year. Since SBA has stated that companies located in LMI areas are likely to be the least sophisticated in terms of management and perhaps most in need of patient capital there remains no valid reason for maintaining the current SBA definition.

   - The Gramm-Leach-Bliley bank modernization act—which for the first time gives banks authority to conduct venture capital operations without an SBIC license—places no restrictions on the period of time for investments. The proposed amendment would be consistent with the new bank law and would serve as an important incentive for banks to retain their SBIC operations—to the benefit of small U.S. businesses seeking financing. Without the amendment, many banks may choose to operate all their venture capital operations outside the SBIC program—to the detriment of small U.S. businesses served by the SBIC program.

2. Issue: The meaning of Section 103(5)(A)(i) as it pertains to control of a small business.

Proposal: Amend Section 103(5)(A)(i) of the Act to read as follows:

(i) shall not cause a business concern to be deemed not independently owned and operated regardless of the allocation of control to be exercised during the investment period in accordance with the investment agreement between the parties;

Rationale:

- SBA regulations prohibit an SBIC from owning a controlling interest in the voting stock of a small business or otherwise exercising control of the small business.
- SBA regulations provide five broad exceptions for taking "temporary control," including the occasion of an SBIC investment in a small business located in an LMI area. The temporary control can last for up to five years—the average life of an SBIC investment.
- The regulations cause inordinate waste of time and resources for both SBA and SBICs in administering the same. Substantial time is spent in each SBA examination of an SBIC determining whether or not the SBIC is in compliance with the control regulations.
- SBA's position is does not recognize the realities of venture capital investing wherein there is often substantial difference between the value of the small business seeking financing and the value of the investment to be made by the SBIC or group of SBICs. SBA's position does not allow the parties to an SBIC investment to structure the investment in the way that may be most reasonable and acceptable from both operating and market perspectives without going through unnecessary "exception" procedures.
- The purpose of the Act is "to improve and stimulate the national economy and the small business segment thereof in particular ...." The focus is on economic growth through job creation. The purpose is not to guarantee control to a senior management team.
- Section 103(5)(A)(i) of the Act explicitly states that an investment by an SBIC "shall not cause a business concern to be not independently owned and operated," SBA has no basis in law for prohibiting control in the context of an SBIC investment.
- SBA has no good rationale for allowing an SBIC to take control of a small business located in an LMI area while prohibiting control in other SBIC investments. Since SBA has stated that companies located in LMI areas are likely to be the least sophisticated in terms of management ability, the prohibition on control cannot be justified in terms of protecting the small business receiving SBIC financing from possible predatory practices.
- The Gramm-Leach-Bliley bank modernization act—which now grants banks authority to conduct venture capital operations without an SBIC license—does not prohibit control. To the contrary, it explicitly permits control during the investment period. The proposed amendment would be consistent with the new bank law and would serve as an incentive for banks to retain their SBIC operations—to the benefit of U.S. small businesses.

3. Issue: The one percent in annual interest and prioritized payments paid to and retained by the Administration may no longer be required to help support subsidy rates.

Proposal: Amend Sections 303(b) and 303(g)(2) of the Act as follows:

303(b): ... Such debentures may be issued for a term not to exceed fifteen years and shall bear interest at a rate not less than a rate determined by the Secretary of Treasury taking into consideration the current average market yield on outstanding marketable obligations of the United States with remaining periods to maturity comparable to the average maturities on such debentures, adjusted to the nearest one-eighth of one percent, plus an addition charge of <u>not more than</u>1 percent per annum which shall be paid to and retained by the Administration<u>, but only to the extent that the 1 percent or a portion thereof is required to offset all or a portion of a positive subsidy rate for debentures as determined by the Administration for the year in question.</u>.

303(g)(2): Prioritized payments on participating securities shall be preferred and cumulative and payable out of retained earnings available for distribution, as defined by the Administration, of the issuing company at a rate determined by the Secretary of Treasury taking into consideration the current average market yield on outstanding marketable obligations of the United States with remaining periods to maturity comparable to the average maturities on such securities, adjusted to the nearest one-eighth of one percent, plus an addition charge of <u>not more than</u> 1 percent per annum which shall be paid to and retained by the Administration<u>, but only to the extent that the 1 percent or a portion thereof is required to offset all or a portion of a positive subsidy rate for participating securities as determined by the Administration for the year in question.</u>

Rationale:

- The additional 1 percent interest obligation was imposed on SBICs in 1996 in order to reduce the Administration's appropriated cost, as determined by the Administration's model, of supporting the SBIC program.
- At least part of the 1 percent in additional interest is no longer required in the Debenture program to keep the subsidy rate at zero. The same may soon be true for the Participating Security program as well.
- Changing the law as proposed would allow the Administration to adjust the additional interest and prioritized payment rates annually based on annual subsidy rate calculations. This is similar to the approach already in place for the SBA's 504 loan program.

4. Issue: The ability of a qualifying SBIC to make a quarterly tax distribution any time during the applicable calendar quarter.

Proposal: Amend the fourth sentence of Section 303(g)(8) of the Act to read as follows:

"A company may also elect to make a distribution under this paragraph at ~~the end of~~ any time during a calendar quarter based on an ~~quarterly~~ estimate of the maximum tax liability for that quarter."

Rationale:

- The proposed amendment is technical in nature and will have no substantive impact on the SBIC program. However, it will save time and expense for both SBA and SBICs by eliminating duplicative filings and inefficient use of SBA resources.
- Under current law, SBICs may make prioritized payment distributions, profit distributions, and other optional distributions (e.g., distributions of capital on any date with prior SBA approval. Tax distributions, however, may only be made at the end of calendar year quarters.
- The practical impact of this restriction is that SBICs are forced to either delay otherwise permitted interim distributions (that would include tax distributions) to the end of a quarter or split their distributions into two distributions—tax distributions (made at the end of a quarter) and all other distributions (made at any time during a quarter).
- Postponing an entire distribution to the end of a quarter has negative cash flow and internal rate of return (IRR) implications for SBICs. Consequently, most SBICs will opt to split their distributions.
- Splitting distributions requires the preparation, submission, and SBA review of two sets of documents when one would otherwise suffice. This results in inefficient use of both SBA and SBIC time and resources.

NASBIC
America's Small Business Partners

Small Business Investment Company Program Statistics
Fiscal Year 1999

A. Number & Size of Investments	Number	Total $ Amount	Average $
Participating Security SBICs	857	652,500,000	761,377
Debenture SBICs	1,115	638,000,000	572,197
Bank SBICs (No Leverage)	798	2,871,300,000	3,598,120
Specialized SBICs	326	59,100,000	181,288
Total Investments	3,096	4,220,900,000	1,363,340

Notes:

1. A total of 1,983 U.S. small businesses received SBIC financing in FY'99.
2. The median investment for bank SBICs was $1 million. For all SBICs it was $375,000
3. The average non-SBIC venture capital investment in 1999 was approximately $7 million.
4. SBICs invested $746 million in Low and Moderate Income (LMI) area businesses in FY'99.
5. Participating Security SBICs have distributed $131 million in profits to the government.

B. Type of Financing Provided	Total $ Amount	Percent
Straight Debt	276,500,000	6.6%
Debt With Equity Features	887,400,000	21.0%
Equity Only	3,057,000,000	72.4%
All Categories	4,220,900,000	100.0%

C. Age of Small Business Financed	Total $ Amount	Percent
Under 1 Year	1,415,100,000	33.5%
1 to 3 Years	828,100,000	19.6%
3 to 6 Years	750,500,000	17.8%
6 to 10 Years	328,000,000	7.8%
Over 10 Years	899,200,000	21.3%
All Categories	4,220,900,000	100.0%

D. Employees of SBIC-Financed Businesses	Average	Median
All Categories	158	27

NATIONAL ASSOCIATION OF DEVELOPMENT COMPANIES

February 25, 2000

The Honorable James M. Talent
Chairman, Committee on Small Business
U. S. House of Representatives
2361 Rayburn HOB
Washington, D. C. 20515-6315

Dear Chairman Talent:

At your request, we are pleased to provide our industry's comments on the Administration's proposed FY 2001 budget for SBA. Enclosed are 100 copies of a Statement concerning:

1. the proposed SBA FY 2001 budget for 504,

2. our industry's recommendations for 504 program reauthorization levels for FYs 2001 through 2003,

3. program needs concerning loan liquidation and recoveries.

The 504 Certified Development Company industry and the many thousands of small businesses who have benefited from the 504 loan guaranty program appreciate your Committee's support over the past fifteen years. During this time, 504 has provided more than 35,000 loans to expanding small businesses, resulting in hundreds of thousands of new jobs and substantial added tax base increases all across America.

Even with the tremendous benefits of competitive, long term financing, 504 has shifted to a "no-cost" program for the taxpayer, as you and Rep. Velázquez have recognized during previous discussions. This program is clearly a great deal for this country.

We need your support to continue these benefits. This year, the program authorization expires without your leadership and Committee action. Further, both the successful Premier Certified Lender Program (PCLP) and our liquidation assistance program for the SBA terminate without Congressional action. Finally, the needed increase in the debenture ceiling to catch up with inflation from the past fifteen years will not happen without your assistance.

We recognize your support for these proposals through passage of H. R. 2614 last year, and look forward to working with the Committee and your staff on the completion of this legislation by Congress during the coming months.

Sincerely,

John Giegel

John Giegel,
NADCO Vice President,
Congressional Relations

CC: Honorable Nydia M. Velázquez, Ranking Member

STATEMENT

by

The National Association of Development Companies

on

The Small Business Administration

504 Loan Guaranty Program
Proposed FY 2001 SBA Budget

Submitted to the

COMMITTEE ON SMALL BUSINESS

UNITED STATES
HOUSE OF REPRESENTATIVES

by

Mr. John Giegel

NADCO Vice President for Congressional Relations
&
President
Wisconsin Business Development Finance Corp.
Madison, Wisconsin

March 1, 2000

Good morning Mr. Chairman and Members of the Committee. I am John Giegel. I serve as vice president for Congressional Relations of the National Association of Development Companies, the trade association for SBA 504 Certified Development Companies (CDCs). NADCO represents 250 CDCs and more than 130 affiliate members, who provided 95% of all SBA 504 financing to small businesses during 1998. NADCO's mission is to serve as the key advocate for the 504 program, thereby ensuring the viability of the most important economic development program in the country today. No other program can claim to have created over 500,000 jobs, as the 504 program has done.

I am also President of Wisconsin Business Development Finance Corporation, Wisconsin's statewide 504 Certified Development Company, with five offices throughout the state and the headquarters in Madison. We have provided more than $300 million dollars in 503/504 financing to over 1,000 businesses since 1981. We are ranked among the largest 10% of CDCs in the country in loan volume.

NADCO would like to thank the Committee Chairman, the Ranking Member, and the entire Committee, for your continued support of the 504 program and the CDC industry. The Committee's passage of H. R. 2614 last year was yet another step towards improvement and expansion of the 504 program, to the benefit of all potential small business borrowers. It is our understanding that this bill is being considered by the Senate Committee on Small Business at this time. We encourage this Committee to work closely with the Senate to obtain quick passage of this bill crucial for the improvement of the 504 program.

I have three objectives in providing this statement to the Committee. First, NADCO has been asked to comment on the FY 2001 budget for SBA. Second, I would like to address the need for a three-year reauthorization of the 504 program. Third, I want to briefly discuss the program's needs regarding loan liquidations and recoveries.

PROPOSED SBA FY 2001 BUDGET

1. 504 PROGRAM AUTHORIZATION CEILING

SBA has proposed that the authorization level for the 504 program be increased from the FY 2000 amount of $3 billion to $3.75 billion. NADCO supports this increase in the authorization ceiling for two reasons. First, long term interest rates continue to climb as banks and other private sector lenders react to interest rate increases by the Federal Reserve. As this Committee knows, higher rates generally lead to a credit squeeze for all commercial and consumer borrowers. Typically, the first segment of the commercial market to lose access to private credit is small business. We see no reason why this cycle of rate increases will be any different that those of the past thirty years. It will be the SBA loan guaranty programs that will be there for America's small businesses when most other private lenders have pulled back from this market, so the requested program level increase is appropriately timed.

Second, the increase in program level by the Administration recognizes the cost-effectiveness of the 504 program. This program, the second largest loan guaranty program in the agency (and the largest economic development loan program within the Federal government), is funded entirely by user fees. There is no appropriation of taxpayer funds needed to deliver this program. Thus, it is extremely efficient, in that, with no up-front appropriation, the 504 program provides added tax revenues to all levels of government. New 504 projects provide new jobs in their communities. Expanded tax bases include:

- **City & County real estate taxes from new construction projects**
- **State & local sales taxes from increased business revenues**
- **Federal income taxes from new and expanding businesses**
- **Federal & State payroll taxes from new employees.**

It is clear that businesses assisted by this no-cost program are contributing to the tax surpluses now being enjoyed by all levels of local, State, and Federal governments. The Administration recognizes the value of the program and has focused on expansion at the right time.

2. 504 BORROWER FEE DECREASE

SBA's proposed budget decreases the annual fee charged each 504 small business borrower from 0.600% to 0.472%. This is a 21.3% decrease in the fee for FY 2001, which comes on top of borrower fee decreases of 11% in FY 98, 6% in FY 99, and 18% in FY 2000. Thus, the cost to the small business for the SBA's 504 loan guaranty fee has declined by 46% over the last four years, offsetting some of the rising interest rates caused by the economy. No other Federal loan guaranty program has decreased in cost to users during this time.

One of the primary reasons for this substantial decrease in cost is the decline in SBA's and OMB's forecast of 504 loan defaults for future cohorts. Since FY 96, this estimate has declined from 19% to 11.1%, a nearly 42% drop in defaults. While due somewhat to a good economy for small businesses, we also must recognize continued improvements in underwriting and loan servicing by CDCs and by SBA staff. Additionally, both the Accredited Lender Program (ALP) and the Premier Certified Lender Program (PCLP) authorized by Congress have led to substantial program improvements during the past several years.

However, the industry has a serious and continuing concern about the forecasts contained in this FY 2001 budget. The SBA CFO estimates that for FY 2001, recoveries of defaulted 504 loans go from just under 25% to about 31%. While an improvement, we believe this recovery forecast is far too low, given that our program is primarily a real estate lending program. The vast majority of collateral we lend against is real estate or immobile large equipment; typically not the kind of collateral that either "walks away" or loses substantial market value even in a loan work-out or a foreclosure situation, especially in the current strong economic climate.

Our industry has proposals to address the recovery issue for our program. I will provide details in sections further on in this statement. We must continue to deal with the need to improve default recoveries. This is a priority that both SBA and our industry are in strong agreement over, and CDCs are devoting thousands of labor hours to improve the liquidation process.

504 PROGRAM THREE-YEAR REAUTHORIZATION

The Small Business Act provides an authorization for the guaranty authority for the Small Business Administration to provide financing under the 504 or CDC program, but it restricts the maximum amount of loan guarantees it may provide in a given year. Historically, legislation has been enacted to provide this program authority for three-year periods.

The most recent law authorized SBA to guarantee CDC debentures in the amount of $3 billion, $3.5 billion, and $4.5 billion in each of fiscal years 1998-2000, respectively. We ask the Committee to provide debenture guarantee levels for three additional years, as proposed below:

- $3.75 billion in fiscal year 2001
- $4.5 billion in fiscal year 2002
- $5.0 billion in fiscal year 2003.

These program authorization levels are not contained in H. R. 2614, referred to the Senate last August. We urge that they be included in your bill, as without a program reauthorization for next year, 504 financing cannot be provided to small business borrowers. We believe these guaranty authority levels are in line with expected program utilization. This will be especially true as commercial lenders begin to tighten credit requirements for small businesses as the economy begins to slow down.

504 PROGRAM LOAN RECOVERY IMPROVEMENTS

The third topic I will address concerns one of the 504 program's most critical areas: loan defaults and the need for improvements in loan recovery. The OMB forecasts for the loan defaults have fallen from 18.9% to about 11% in four years. This is through more than just improvements in the program. This decline is a clear testament to the ability of CDCs and SBA to efficiently deliver 504 as Congress intended it. We also believe that OMB is better able to forecast an accurate default rate by taking a reasonable view of the fifteen-year performance history of our portfolio. Thus, we accept their forecast of program loan defaults, and recognize that CDCs and SBA field staff are doing a good job of meeting the borrower needs set forth by Congress.

However, recoveries from 504 loan defaults are another matter. The FY 2000 budget indicated the recovery for our portfolio by SBA Portfolio Management staff has fallen from 44% to under 25% in the last four years, and have just been increased to about 31% for FY 2001.

We believe that further action must be taken to keep the program recoveries on an upward trend. Quick action on the part of Congress may mean the difference between long term survival or failure of the 504 program. Last year, the Committee passed H. R. 2614, which addressed the need for recovery improvements in three ways:

1. PREMIER CERTIFIED LENDERS PROGRAM

Legislation enacted in 1994 (P. L. 104-403) authorized the Premier Certified Lenders Program (PCLP). Under this program, experienced CDCs may request SBA to delegate to them debenture approval authority; in return, they agree to reimburse SBA for 10% of any loss on a debenture guaranteed by SBA under the delegation of authority. The program was to originally sunset in 1997 and this sunset was subsequently extended to the end of fiscal 2000.

We believe that the program has proven itself. It has reduced the time required to process a CDC loan, reduced the involvement of SBA personnel, and has not resulted in increased losses to the Government.

More CDCs are prepared to step forward to utilize this program in improving small business assistance, while reducing taxpayer exposure to loan losses. However, many are waiting to see if the program will become permanent, and are looking for detailed regulations and policy guidance from SBA. Given the history of recovery by SBA, they are reluctant to agree to carry up to 10% of the total exposure until they can actively carry out full and effective independent recovery efforts. These must include all phases of the liquidation process -- INCLUDING the ability to litigate against the defaulted borrowers or loan guarantors.

Your bill makes the PCLP program permanent and provides SBA with guidance concerning PCLP liquidation authority. We appreciate your confidence in our industry, and urge that this language be included in the final bill.

2. SALE OF DEFAULTED LOANS

As a condition of participating in the Premier Certified Lenders Program and being allowed to issue an SBA guarantee of the debenture, a CDC must agree to reimburse the agency for 10 percent of any loss SBA sustains due to a default and claim against the guarantee.

SBA has completed the first sale in a pilot program to package and sell pools of defaulted loans, including both 7(a) loans and 504 debentures. SBA, while publicly acknowledging positive results, has not informed NADCO any specific impact of this sale on the 504 recovery projections by OMB. We have continued concerns about the impact on the 504 program fees, as one of the primary factors in calculating the borrower fees is the forecasted recovery rate for each year's loan cohort.

It is our understanding that SBA is preparing a second sale of assets for sometime in the next several months. Given that our industry and, to our knowledge, the Committee has not received detailed results of the first sale, we have questions about the expectations for the second sale. Have the results exceeded the 504 cost model recovery forecast for FY 2001 of 31%? Have the results exceeded those of the liquidation pilot, with both the CDCs in the pilot and the SBA control group gaining recoveries exceeding 50% of the outstanding balance?

We are deeply concerned that SBA is moving towards a loan recovery plan that may not maximize results. Unfortunately, it appears that lack of public reporting of the results of the first sale and expectations for the second sale leave us with a lot of questions and no answers. We encourage the Committee to seek clear indications of these results, before considering further support for asset sales concerning SBA 504 defaults.

For 504 debentures issued under PCLP, the CDC assumes partial liability in the event of a default and ultimate loss. We believe that this potential 10 percent liability equates with ownership and that affected CDCs should be afforded a similar opportunity to insist on loan liquidation rather than recovery only through any SBA asset sale. This right to insist on liquidation rather than an untried sale will become even more important if the CDC qualifies for the delegation of liquidation authority.

We ask the Committee to provide this right to liquidate their defaulted loans to PCLP CDCs. Given the recovery history of SBA, we believe fewer qualified CDCs will volunteer to assume increased portfolio risk without the right to directly recover project assets in the event of a loan default. Such authority for qualified CDCs should include all phases of the liquidation process, from loan workout negotiation, through asset sale, foreclosure, and litigation.

3. LOAN LIQUIDATION

Historically, if a small business borrower defaulted in repayment of a loan made by a CDC, the SBA handled foreclosure and liquidation of any available assets or suits against loan guarantors. As part of privatization and downsizing of government, CDCs suggested that they be authorized to perform the liquidation and foreclosure of loans they made that defaulted. Our goal was to assist overburdened SBA staff by providing the added resources of both CDCs and outside subcontractors. The expected results were: (1) more timely recoveries and, (2) an increase in the percentage of recovery of the outstanding loan balance.

1996 legislation mandated the operation of a loan liquidation pilot program under which certain experienced CDCs would receive a delegation of authority from SBA. The pilot commenced in June 1997, and an SBA report to this Committee was provided to Congress last year on the first two years of the pilot operation.

In light of deteriorating SBA recovery statistics and preliminary pilot CDC performance, Senate-passed legislation in 1998 would have established a permanent CDC liquidation program in lieu of the limited pilot. An added benefit of making the program "permanent" rather than a "pilot" is that OMB, in computing the subsidy rate for the CDC program, would score the savings achieved by the CDCs liquidating their own loans.

The Senate bill also would have expanded the number of CDCs who could seek delegated authority to foreclose, liquidate, and litigate the defaulted loans. Unfortunately, that bill was not enacted by the Congress. Given the continued fairly low recovery percentage forecasted in the FY 2001 Administration budget, we are again proposing several minor changes in the Senate-passed language. These proposals are explained in the sectional analysis already provided to the Committee staff.

One of the important benefits of our proposal for the program would be a quicker review and approval of liquidation and workout plans by SBA staff. As the Committee knows, in recovery of loan collateral, time is truly money. The longer an asset sits vacant, the more it deteriorates, is vandalized, or even "disappears" from its location. CDCs need the ability to quickly move to protect assets that have become government property through loan default. To perform this mission, the approval paperwork must be processed faster by SBA than it is today.

A second major benefit of our proposed language is the empowerment of qualified CDCs to use their internal or external contractor resources to perform the entire recovery process -- including full litigation against a defaulted borrower or guarantor. Just as time is so important in the recovery of value for assets, so the amount of staff effort is. The liquidation process is extremely labor-intensive. This is, in fact, SBA's main problem in the recovery process; the agency simply doesn't have enough qualified staff to perform recoveries for the growing 7(a), disaster, direct, and 504 loan programs. We strongly believe there are many highly qualified portfolio management and legal staff at SBA; there simply aren't enough of them.

NADCO believes that, if CDCs are empowered by Congress to use both their available staff resources AND ALSO those who may be employed as outside contractors dedicated to assist in our recovery efforts, we can have a truly positive impact on the declining recovery percentage. But, to be successful, we must move quickly to expand both the pilot and authorities delegated to CDCs by SBA. We ask the Committee to work closely with the Senate to support making the liquidation pilot a permanent part of the 504 program.

SUMMARY

There are many issues to be addressed for the 504 program if we are to both improve it, and stabilize the declining loan recovery rate. NADCO recognizes the Committee's support for changes to improve and expand the program across America. We hope you will press the Senate for quick passage of H. R. 2614, to include a three year reauthorization of the 504 program.

Thank you, Mr. Chairman, for allowing us to provide our comments today. CDCs are major stakeholders in the 504 Program and want to do everything we can to ensure its long term viability. We consider recovery problems a very serious matter, and we look forward to working with your Committee and the SBA in reversing the current trend quickly. Only through this effort can we bring the 504 program fees back to a reasonable level for all small businesses.

Association of
Small Business
Development Centers

STATEMENT OF

WOODROW C. MCCUTCHEN

PRESIDENT

ASSOCIATION OF SMALL BUSINESS DEVELOPMENT CENTERS

SBA's FISCAL YEAR 2001 BUDGET REQUEST
AND REAUTHORIZATION

BEFORE THE

COMMITTEE ON SMALL BUSINESS

U.S. HOUSE OF REPRESENTATIVES

MARCH 1, 2000

Statement of

Woodrow McCutchen

President, Association of Small Business Development Centers

March 1, 2000

Chairman Talent, Ranking Member Velazquez, and Members of the Committee; I am Woodrow McCutchen, President of the Association of Small Business Development Centers (ASBDC). I am here today representing the nation's fifty-eight SBDC state and regional programs. I would like to thank you Mr. Chairman and the members of this committee for inviting the ASBDC to testify at this hearing to discuss reauthorization of the Small Business Administration and its programs as well as the SBA's FY 2001 Budget request. With me today is Donald Wilson, Director of Government Affairs for the Association.

At the outset of my remarks I would like to express the appreciation of the Association, the fifty-eight state/regional SBDC network programs, and the network's approximately 4,500 employees for over two decades of bipartisan support that the SBDC program has received from Congress. Congress initiated the SBDC program as a pilot in 1977 and formally authorized the program in 1980 in Section 21 of the Small Business Act. Since the program's inception, thousands of dedicated men and women have worked diligently to fulfill the mission Congress envisioned when the SBDC program was created.

In 1981, the SBDC program had fewer than 100 locations in 19 states. Today the program has roughly 1, 000 locations in all 50 states, the District of Columbia, Puerto Rico, the Virgin Islands, Guam and American Samoa. We have several hundred additional service sites that we utilize on an outrider basis. In the last 20 years, Small Business Development Centers have provided counseling and training to approximately eight (**8,000,000**) million small business and pre-venture clients. All of us affiliated with this program are proud of our proven record of cost effective delivery of management and technical assistance to the nation's small business community.

The ASBDC would also like to take this opportunity to make clear our appreciation of the commitment the Clinton Administration and Administrator Alvarez have made to this program in this year's budget. We realize budget decisions are never easy. However, ASBDC and the SBDC network believe the Administration's budget request of $88 million (including $3 million earmarked for a Native American SBDC) is a demonstration of a renewed awareness within the agency of the importance of the SBDC program and its services to the nation's rapidly growing small business community.

The chart below reflects the SBDC program's documented track record of service delivery to its small business clients. The nation's roughly 23 million small businesses employ over 50% of the national workforce and continue to be the driving force behind this country's economic growth and job creation. If we are to continue to enjoy economic growth and prosperity, then America's burgeoning entrepreneurial population must be given the management tools to succeed.

Access to financing is critical to the success of many new small businesses. However financing alone will not ensure success. Start up businesses and pre-startup businesses comprise a significant share of our client base. The management training and technical assistance we provide have proven to make a difference. Our clients have a rate of sales growth and employee additions that exceed the national small business average. And as a result those firms contribute to the federal treasury at a faster rate of increase than non-SBDC client firms. This is a win/win situation for all concerned. And the economic stability that our clients achieve as a result of our management and training assistance contributes to lower default rates on small business loans. It is also important to recognize that data indicates that slightly over 50% of our pre-venture clients go on to start new businesses within two years.

I would like to state for the record that the ASBDC and the SBDC network are solidly committed to helping "open doors" of economic opportunity for individuals and communities in "New Markets". In fact our network's doors have been opened wide to these constituencies since the inception of the SBDC program. And those constituencies utilize our services every day. In 1999, over 42% of our counseling and training clients were women and nearly 23% were minorities. Moreover, approximately one-fourth of our service centers are located in targeted economic revitalization areas such as HUBzones, Empowerment Zones and Enterprise Communities. SBDCs are therefore well positioned to play a significant role in publicizing these important federal initiatives.

The SBDC program stands ready to help the administration achieve its goal of 1.4 million additional small business clients in FY 2001. The numbers below reflect the numbers of small businesses and pre-venture clients we are reaching. We can do more if provided with adequate resources. If Congress decides that additional small business technical and management assistance outreach efforts are necessary, and we believe they are, then the SBDC's established infrastructure of over 1,400 service locations is the most logical vehicle to effectively accomplish that mission. We hope that rather than trying to create a redundant infrastructure for new, targeted management and technical assistance initiatives, that SBA will utilize the SBDC network's existing infrastructure to deliver some of these new programs.

SBDC funding in FY 1999 was up less than one percent over FY 1998. By comparison, overall counseling and training clients were up nearly 9 percent. The number of women clients was up nearly 11 percent and the number of African-American clients was up nearly 16 percent. The number of Hispanic clients was up nearly 10 percent as the chart below confirms.

SBDC FEDERAL FUNDING	FY 1998	FY 1999	PERCENT CHANGE
	$76,700,000	$77,320,455	0.80%
SBDC PROGRAM CLIENTS	FY 1998	FY 1999	
Total Counseling Cases	237,655	263,927	11.00%
Total Training Attendees	309,382	331,464	7.10%
* Women	229,034	254,047	10.90%
*Veterans	41,370	43,287	4.60%
*American Indian/Alaskan	5,380	6,335	17.70%
Black	47,178	54,641	15.80%
Hispanic	30,653	33,664	9.80%
Asian American	11,192	10,170	-9.10%
Native Hawaiian/Pacific Islander	combined with Asian American	3,471	
Total Clients Served	547,037	595,391	8.80%

* New market breakouts show combined counseling and training

During the last seven years, our nation has been blessed with remarkable economic growth. We have also faced major economic change. Economic downsizing by corporations, especially in the manufacturing sector, declining agricultural exports, the Y2K crisis, and unprecedented technological change have all contributed to a sharply increased demand on our nationwide SBDC network for counseling and training. I am proud to say that our SBDC network has risen to that challenge. This nationwide growth in demand creates a genuine need not only to sustain but also to grow the SBDC program.

The Global Entrepreneurship Monitor (GEM), a joint research initiative by Babson College **and the London Business School sponsored by** the Kauffman Center for Entrepreneurial Leadership **reports the annual start-up of** 600,000 – 800,000 new companies in the United States that create real jobs. **The GEM reports that right now** 16 million Americans **are trying to start a business of their own. According to theYankelovich survey "Life in the Year 2010", 37% of current employees say they will own their own business in 2010.**

This rise in entrepreneurship is unprecedented in our recent history. This "New Economy" is creating increasing demands on our network. Although the SBDC's resources are presently stretched, the program has shown a remarkable capacity not only to meet the congressionally mandated matching requirement, but also to exceed it. The SBDC network nationwide uses its congressional appropriation to leverage over $100 million of dollars from local and state governments, educational institutions, as well as individuals and corporations in the private sector. And we believe we can leverage additional non-federal resources if the federal government's demonstrates its awareness of this increase in entrepreneurism and commits additional resources to these small business needs.

We are asking, Mr. Chairman, that this committee approve and recommend to the full House of Representatives that the SBDC program be re-authorized at **$100 million in FY 2001, $105 million in FY 2002** and **$110 million in FY 2003**. The ASBDC believes these levels of authorization are crucial if the SBDC network is to continue to address the nation's growing number of startups and existing businesses, businesses that are creating jobs and fostering overall national economic growth. We are also urging this committee to encourage the House Budget Committee to consider directing a larger share of federal resources to small business assistance.

Our nation's budget priorities must begin to reflect that small business growth is clearly a major contributing factor to the longest peacetime economic expansion in our history. Congress needs to demonstrate in its spending allocations that it recognizes that job growth and continued federal surpluses are tied inextricably to the health of our economy's small business sector. We believe that, at a minimum, the **SBDC program will need an appropriation of $90 million, net of earmarks from Section 21 funds,** if it is to address the growing needs of the nation's exploding entrepreneurial population.

Additionally, there is a crying need for vastly expanded small business regulatory compliance assistance. While SBDC programs have provided a measure of this assistance in recent years, regulatory compliance needs today are far more comprehensive.

The ASBDC is working with the Association of Disabled Veterans and other veterans groups, on behalf of the network, to develop and implement a major initiative to provide improved and expanded services to the nation's veterans. We are also working closely with the SBA and the Department of Veterans Affairs to fulfill our obligations under the Veterans Entrepreneurship Act.

The SBDC program for two decades now has utilized the dollars that Congress has invested in the program to create a strong and viable infrastructure. The program has developed over 3,400 strategic resource partners including educational institutions, lending institutions, economic development agencies at the state and local level, Chambers of Commerce, etc. Examples of these strategic resource partners include Mayer, Hoffman, McCann Certified Public Accountants and the St. Louis Economic Council in your home state of Missouri, Mr. Chairman; Citibank and Bank of America in Brooklyn, NY; Rock Valley College and Amcore Bank in Rockford Illinois; Cook County, Illinois Department of Economic Development; the California Manufacturing Technology Center in Torrance, California; Frostburg, Maryland State University; Arthur Andersen in New Jersey; Meadville, Pennsylvania Redevelopment Authority; the Wharton School in Philadelphia; Billings, Montana Area Chamber of Commerce, New Mexico Association of Community Colleges; the Hispanic Chamber of Commerce of San Antonio, Texas; the Greater Cincinnati, Ohio Venture Association; the Council of Smaller Enterprises in Cleveland, Ohio; Ernst and Young LLP, in Overland Park, Kansas, White County, Indiana Industrial Foundation, Amarillo, Texas Chamber of Commerce; ATT Capital Corporation of Georgia; Alabama Minority Supplier Development Council; the Women's Initiative Networking Group in Kentucky; and Wachovia Bank in North Carolina, to name just a few..

This infrastructure and its partnerships are unmatched by any other management and technical assistance program. It would take years and enormous financial resources for any other program to replicate this infrastructure. It is critical that this committee fully appreciate this fact. Last fall you will all remember the terrible devastation that Hurricane Floyd inflicted on North Carolina and a number of other states. Tens of thousands of individuals lost their homes and businesses. In North Carolina for example, the SBA, and the State of North Carolina turned to the North Carolina Small Business and Technology Development Centers (SBTDC) to take the lead in coordinating the delivery of disaster business assistance to those whose lives had been changed overnight by the storm's fury. North Carolina SBTDC employees from across the state packed up and moved to the hardest hit counties, staying in motels and working seven days a week to process disaster loan applications and provide other forms of business assistance. Similar efforts have occurred recently in South Carolina and North Dakota. Without the SBDC infrastructure and personnel, delivery of business disaster assistance and business recovery efforts following those hurricanes and floods would have been far less effective.

The SBDC program is the only federal small business management and technical assistance program that is subject to a congressionally mandated certification program. The ASBDC also contracts with an independent consultant for a biennial economic impact assessment of long term SBDC counseling. That assessment documents that SBDC clients increase sales, and new employees at a rate significantly above that of the average small business. In 1996, the last year for which we have such data, SBDC counseling clients experienced sales growth per business at almost four times the rate of the average U.S business. Job creation for SBDC clients was 1.29 jobs per business compared to .22 jobs per business for the average U.S business.

Mr. Chairman we are working with your staff and that of Ranking Member Velazquez to address essentially technical changes in the program's funding formula so that the formula will be easier for everyone, State Directors, SBA personnel, etc., to understand. We have also made staff aware of our concerns that the SBA, not compromise the client confidentiality that is so essential to the SBDC– client relationship. This is a concern that is shared by other SBA resource partners. We are most appreciative that staff of this committee, both majority and minority, have always been available to us and extremely helpful. Their professionalism is a reflection of the leadership provided by you Mr. Chairman and by Ranking Member Velazquez.

Mr. Chairman, in summary, the SBDC program is the federal government's largest and most successful small business management and technical outreach assistance program. We have an established, proven infrastructure without peer. We have a documented track record of responding to the needs of the communities we serve. Our clients represent the face of those communities, including rural and urban populations, minorities, women and Native Americans. We currently provide counseling and training to nearly 600,000 small business clients annually. And these numbers do not reflect the hundreds of thousands of information and referral contacts we process annually.

The SBDC network is well positioned to deliver an increased level of management and technical assistance to a significantly expanded client base if the program is provided the resources to do so by Congress. This is a commitment we can and do make to this committee today. And we ask for this Committee's support for the program's reauthorization at funding levels that will allow the program to remain innovative and to meet the needs of the nation's 23 million small businesses.

Thank you Mr. Chairman. I would be pleased at this time to answer any questions that members of the Committee might have.

ASSOCIATION FOR ENTERPRISE OPPORTUNITY
(AEO)

Testimony Before the House Small Business Committee
Caroline Hayashi, Program Director, Enterprise Development Group
Wednesday, March 1, 2000

Good morning Chairman Talent and members of the House Small Business Committee. Thank you for the opportunity to testify before you today. My name is Caroline Hayashi, a member of The Association for Enterprise Opportunity, (AEO) as well as Program Director for the ECDC Enterprise Development Group in Arlington, VA. My testimony represents the views of AEO as well as the Association of Women's Business Centers.

Founded in 1991, AEO is the national association of organizations committed to microenterprise development. AEO provides over 490 organizational members with a forum, information and a voice to promote enterprise opportunity for people and communities with limited access to economic resources. A good number of AEO members are SBA Intermediaries as well as Women Business Centers.

Small business is the backbone of the U.S. economy, accounting for 53% of all jobs (Office of Advocacy, Small Business Administration). Though often overlooked, the smallest firms within this realm, self-employed individuals and microenterprises employing fewer than five workers, are playing an increasingly vital role. Despite their critical role, many microentrepreneurs have difficulty obtaining management assistance and capital. Microenterprise development provides these disadvantaged entrepreneurs with the training and technical assistance, credit, access to markets, and asset development opportunities they need to grow their businesses, increase their incomes, tap new markets and create jobs.

In the past decade, the microenterprise development sector has grown rapidly, reaching over 55,000 entrepreneurs in 1997. Yet the demand for microenterprise services far exceeds the limited resources of the field. The Aspen Institute's Self-Employment Learning Project has estimated that there are at least two million low-income entrepreneurs in the US, a figure that does not include moderate-income entrepreneurs.[1]

Largely through the loan and grant funds from the US Small Business Administration, in the last four years, as an AEO member, The ECDC Enterprise Development Group has been able to provide loans to more than 150 small business owners totaling over $1.6 million, created and retained over 320 jobs and provided business management assistance to over 2,500 entrepreneurs.

The ECDC Enterprise Development Group is a subsidiary of the Ethiopian Community Development Council, Inc., founded in 1983 to improve the socioeconomic condition of underserved populations and promote sustainable economic development in the Washington, DC metropolitan area. The ECDC Enterprise Development Group helps low-to-moderate income individuals become economically self-

[1] Aspen Institute, *Microenterprise and the Poor, 1999*

sufficient through the start up and expansion of small businesses by providing entrepreneurs with access to capital and management assistance they need to be successful.

ECDC assists businesses that do not have access to capital, business information and resources elsewhere. Small business ownership creates an opportunity for those of all educational levels, age, race and class. However, low-to-moderate income individuals, particularly minorities, women and refugees, are often unable to access the credit they need to grow or start their businesses due to poor or no personal credit history, insufficient collateral and money to invest, lack of sufficient business history and/or capital needs that are too small.

Although these loans are uneconomical for for-profit entities to provide, these businesses promote economic self-sufficiency through the income and jobs that they create and retain and promote local economic development through the goods and services that they provide. They also help keep individuals off of welfare and help build the local tax base.

An entrepreneur who demonstrates the impact small business can have on the owner as well as others in the community is Kyung Hee Park. Ms. Park is a 40-year-old woman who five years ago suddenly found herself a single mother of two small children living in a homeless shelter. She found an opportunity to partner with a man who wanted to start a siding and flooring business. After the first year in business, the company had not made a profit and her partner gave his portion of the business up. She decided to continue the business herself to try to make a better life for her and her children. Two years ago, she came to ECDC for a loan to expand her business. She had approached over 20 other financial institutions for a loan and was turned down because of credit problems she experienced while living in the shelter. Since that loan three years ago, she increased her sales by more than 500% and went from 5 contractual employees to more than 20 full time employees. She went from doing small residential jobs to obtaining large-scale commercial contracts for companies such as U-Haul and received a sub-contract for a U.S. Department of Housing and Urban Development housing complex.

SBA has been a critical resource partner for ECDC. ECDC has $1.5 million in loan funds from the SBA, which constitutes half of our capital pool. In addition, SBA provides critical grant funds that are used to provide the business management assistance that is required for our clientele. This grant support allow us to maintain a less than 5% default rate on a portfolio comprised of extremely high-risk clients and allows us to maintain an 85% business success rate, which defies small business national averages.

Given the vast, unmet and growing needs of microenterprises, it is critical for the Committee to know how much we in the field rely on SBA programs to do our work. In particular, we depend on the SBA Microloan Program and the OWBO Women's Business Centers. In addition, Congress last year authorized a new program, PRIME, which is a technical assistance and training program for low-income microentrepreneurs. We believe that as part of this year's SBA Reauthorization, we must insure that all these programs maintain at least their currently authorized funding levels and, if possible, they should be Increased. These programs are the lifelines for many microenterprise organizations like mine throughout the country and they greatly assist our work.

As this Committee and Congress moves forward with the SBA Reauthorization process, AEO would like to make the following recommendations, based on our collective experience with the Microloan program and the perspective of a large portion of AEO's membership. As important and valuable as the SBA Microloan program is to us, and to small and micro-entrepreneurs, we believe certain changes could make the Program better.

Give Successful State Programs a Better Chance to Access Assistance

We believe that states with successful or capable microlending intermediaries ought not be limited by an arbitrary formula which regulates how much funding is available state-by-state. By eliminating this formula, we think the best programs, serving the most people, will be able to access assistance based on need and demand, not geography.

Reduce Confusing Interest Rate Regulations

It is often confusing, both to program participants, as well as the SBA, to administer different interest rates for different loans, loans, which are tied to the five-year Treasury bill interest rate. SBA could allow for a singular interest rate buy down for all intermediaries.

Let Local Programs Determine the Best Forms of Technical Assistance

We think it is duplicative and unnecessary for the SBA to proscribe how much technical assistance is available for assistance delivered before a loan and after one. This type of micromanagement restricts program flexibility and does not add to the program's safety, i.e. does not prevent default, which we think the SBA monitors effectively without this type of intrusion.

Raise the Loan Cap to Reflect Increases in the Cost of Doing Business

Like any dollar limitation fixed in legislation, the maximum allowable loan of $25,000 has eroded since 1991, when the cap was instituted. We believe this cap should be raised to reflect increases in the cost of living and doing business in the microlending field. The same principle applies to those lenders who qualify to make very small loans to their clients. The $7,500 limit that exists for these intermediaries should also be raised.

Encourage Greater Cooperation Among Microenterprise Partners

AEO would like Congress to lift the maximum loan allowable in joint ventures. By limiting the loan amount to $25,000 for projects with other lenders, we unduly restrict the ability of intermediaries to expand micro-businesses. This level should be lifted, as well.

In doing so, the SBA Microloan Program would be able to provide a more streamlined and efficient microloan fund while improving technical assistance to both new and existing microlending intermediaries.

In addition to supporting the above-mentioned recommendations, AEO also supports full funding at the authorized level of $12.8 million of the SBA Women's Business Center Program.

Thank You

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THE BOND MARKET ASSOCIATION

Statement of The Bond Market Association

for the

U.S. House of Representatives
Committee on Small Business

March 1, 2000

The Bond Market Association represents securities firms and banks that underwrite, trade and sell debt securities, both domestically and internationally. The Bond Market Association's members include a number of firms who are active in the secondary market for loans guaranteed under the Small Business Administration's (SBA's) section 7(a) program, and for pool securities backed by those loans.

Prepayments on 7(a) Loans

Over the past several years, we have noticed an alarming increase in prepayment rates among 7(a) borrowers. In many cases, loan prepayments can be indicative of the improved financial health of a borrower. If a small business generates greater-than-expected net income, it may be able to repay its debt faster than anticipated. A 20-year loan might be paid off in, say, 15 years. This form of prepayment behavior is expected in any lending market where borrowers are able to prepay loans at any time without penalty, and can be viewed as a success of the 7(a) program. However, we believe recent trends in the pattern of certain prepayments among 7(a) borrowers suggest not a success of the program, but a threat to its effectiveness.

Recent trends suggest that many of the 7(a) loans that prepay very early do so not because borrowers met with unanticipated success and were able to pay down debt from business profits. Rather, it is evident that much of the early prepayment activity results from the actions of conventional lenders who market refinancing transactions to 7(a) borrowers. Often, the non-SBA refinancing loans carry marginally better terms—lower and fixed interest rates, longer maturities, etc.—than SBA loans. Very early prepayments on 7(a) loans result from these refinancing transactions. At first glance, this may appear to be a desirable outcome of the 7(a) program. Borrowers are "graduating" to conventional financing. However, if a borrower is able to qualify for a conventional, non-federally-guaranteed loan shortly after settling on a SBA-guaranteed loan, it is highly likely that the borrower did not need the SBA guarantee in the first place to qualify for financing. In essence, the borrower is using the 7(a) program as a form of short-term bridge financing. It is also likely that another, more needy borrower was displaced and could not obtain SBA financing as a result. Moreover, this very fast refinancing activity is the result of "cherrypicking." Lenders offer refinancing transactions to only the most attractive and credit-worthy SBA borrowers. Those loans that are not refinanced—the loans that remain federally guaranteed and through which the federal government is exposed to default risk—tend to be riskier.

Very fast prepayments also affect the marketability of 7(a) loans in the secondary market. Pools of SBA-guaranteed loans are priced in the secondary market based on assumptions regarding the prepayment speed of loans in the pools. If an unexpectedly large number of loans prepays very early, an investor's rate of return on his or her investment is affected. Eventually, investors will begin to demand higher rates of return on SBA-guaranteed loan pools to compensate for inordinately fast prepayments. Indeed, we have begun to witness this effect in the secondary market for 7(a) loans as a result of prepayment behavior. Higher rates of return for investors translate into higher borrowing rates for small businesses.

House Passed 7(a) Bill Benefits Borrowers

On August 2, 1999 the House of Representatives passed H.R. 2615, legislation to make improvements to the SBA's 7(a) loan program. One provision of H.R. 2615 is designed to strengthen the 7(a) program by curbing the very early prepayment of medium- to long-term small business loans. If left unchecked, these prepayments would increase the cost of capital for borrowers and threaten the long-term viability of the 7(a) program as a ready source of capital for worthy small business borrowers who otherwise may not have access to investment capital.

The House bill includes a provision for modest, graduated prepayment charges for borrowers who prepay their long-term loans in the first five years. The Bond Market Association strongly supports this provision. We support it because we believe it would apply only to loans that, by their terms, are intended to supply long-term business financing, and would therefore discourage the number and volume of extraordinary, very early prepayments which are harmful to the 7(a) program. It would do so without penalizing borrowers who, as a result of business success over a reasonable time frame, are able to repay loans more quickly than expected. Discouraging very early prepayments without penalizing businesses who prepay loans later in their terms strikes an appropriate balance. By reducing prepayment risk to investors, prepayment charges also would benefit borrowers through lower financing costs. If investors view their 7(a) loan investments as less risky, they will demand lower rates of return, which in turn translates into lower borrowing costs for small businesses. This effect has been documented in other loan markets where prepayment charges have been introduced.

Summary

We believe that the SBA's section 7(a) loan guarantee program is effective and successful. It is a proven and efficient source of long-term capital for small businesses that otherwise would find it difficult or impossible to qualify for financing. An active and robust secondary market for 7(a) loans has been and remains vital to that success. Our above-mentioned concerns regarding the program could threaten the viability of the secondary

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market in 7(a) loans. Unusually high levels of very early prepayments represent not a sign of the program's success, but rather a threat to its continued viability.

We strongly support the prepayment legislation passed by the House.

THE BOND MARKET ASSOCIATION

Appendix

The secondary market for 7(a) loans

Congress created the SBA in 1953 to aid, counsel, assist and promote small business and expand access to capital by guaranteeing private loans. Such loans were expected to carry longer terms and lower interest rates than small businesses would otherwise be able to obtain in a private commercial lending transaction. The secondary market for SBA loans began in 1975 when market participants and the SBA worked together to allow for the sale of the guaranteed portions of SBA loans. The program permits the lender of an SBA loan to retain the unguaranteed portion and servicing of the loan and sell the guaranteed portion to a secondary party, often a dealer, who then may re-sell the SBA-guaranteed loan to an investor, transferring full rights of the government's guarantee. This secondary market liquidity frees lenders' capital for the origination of additional small-business loans, thereby giving small businesses valuable access to more capital.

In 1984, the Small Business Secondary Market Improvement Act provided for the central registration and servicing of loans sold in the secondary market by a single fiscal and transfer agent, Colson Services Corporation. In addition, the 1984 Act allowed for the pooling of SBA loans with the intent of providing increased efficiency, better liquidity and a more established and improved SBA product in the secondary market. Accordingly, such improvements allowed secondary market participants to structure securitized SBA loans to be attractive to institutional investors by creating pools of similar loans diversified geographically and by amount, lender and industry sector, and provide a timely guarantee of monthly principal and interest to investors. In sum, each of these legislative, regulatory and market developments has served to further recognize, expand and improve the efficiency and liquidity of the secondary market in SBA loans. However, even with such improvements, we believe that the secondary market for the 7(a) program could be further strengthened by addressing targeted issues.

The Benefits of Secondary Market Activities

Securitization and secondary market trading of loan pools were introduced into the U.S. capital markets on a widespread basis in the early 1970s with the creation of the Government National Mortgage Association, or Ginnie Mae. Ginnie Mae, by providing credit support for securitized FHA and VA mortgages, made it possible for home mortgage lenders to sell pools of loans into the secondary market. Since that time, the market for securitized home mortgages has blossomed. In 1999, more than $687 billion of agency MBS were issued.

Secondary market activities, including the trading of whole assets as well as the conversion of pools of assets into tradable securities, have also evolved in the markets for a wide range of other financial assets. It is now quite common for lenders to sell or securitize car loans, credit-card receivables, lease contracts, trade receivables, even royalties from intellectual property, among other assets. Last year, nearly $200 billion of publicly offered ABS was issued, and this year promises even higher volume. The SBA permits the trading and securitization of both the guaranteed and unguaranteed portions of loans made under the 7(a) program. Securitization of the guaranteed portion of loans is much more common, and since 1985, $23 billion of SBA-guaranteed loans have been securitized or sold in the secondary market.

The secondary market provides several benefits for lenders and borrowers. First and perhaps most important, securitization provides lenders with a ready and efficient means of selling assets in order to raise capital to generate additional lending. Rather than being forced to carry a loan on its books for its entire term, lenders are able to sell loans to investors and use the proceeds of the sale to make additional loans. Second, securitization attracts sources of capital to lending markets that would never be available otherwise. Securitized SBA loans are sold to a wide range of investors, including pension funds, mutual funds, insurance companies, endowment funds and others. Few, if any, of these investors would ever consider making a small business loan directly. However, because securitized loans are standardized and liquid, they are easily marketable to a variety of investors. Third, the secondary market gives financial institutions and other lenders flexibility in managing the assets on their balance sheets. As market conditions and business strategies change, lenders are able to expand or contract their balance sheets easily and efficiently, for example, to better match their assets and liabilities. In combination, the existence of liquid and efficient secondary markets for SBA debt obligations has resulted in more widespread availability of capital, at lower cost, for small business borrowers.

The secondary market has become an increasingly integral component of the 7(a) program. As a result, it has become ever more important for program administrators to be sensitive to issues that affect the secondary market for SBA-guaranteed loans. Issues such as liquidity and investor confidence have become important to the success of the SBA's programs. If investor confidence in securities backed by SBA-guaranteed loans wanes, the 7(a) program would suffer significantly. Fundamentally, we believe that the 7(a) program is well designed and well managed. The program meets the needs of small-business borrowers and benefits the economy overall in ways that no other government initiative does. By passing H.R. 2615 the 7(a) program could be made stronger and more beneficial to America's small businesses.

JAMES M. TALENT, MISSOURI
CHAIRMAN

NYDIA M. VELÁZQUEZ, NEW YORK

Congress of the United States
House of Representatives
106th Congress
Committee on Small Business
2361 Rayburn House Office Building
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February 16, 2000

BY HAND

Honorable John Kasich
Chairman
Committee on the Budget
U.S. House of Representatives
Washington, D.C. 20515

RE: Budget Views and Estimates

Dear Chairman Kasich :

The Committee on Small Business submits these views and estimates on the FY 2001 budget submission on matters within our jurisdiction in compliance with Rule X, clause (4)(f), of the Rules of the House of Representatives. These views and estimates are based on the President's Budget for FY 2001 as well the Small Business Administration's budget submission. The President's proposed budget for FY 2001 requests $1.062 billion for the Small Business Administration, an increase of $336 million over FY 2000.

While the Committee believes that many of the provisions of the budget are reasonable, we can not agree with all of the spending proposed in the FY 2001 budget proposal. These views and estimates will divide the Small Business Administration into five areas; (1) Financial Programs, (2) Assistance Programs, (3) Disaster Assistance, (4) Salaries and Expenses, and (5) Office of Inspector General.

(1) SMALL BUSINESS FINANCIAL PROGRAMS

SUMMARY

The FY 2001 SBA proposed budget for small business financial assistance discusses building a twenty-first century financial management organization and providing assistance for small business. The President's Budget requests a total of $332.25 million in subsidy budget authority for financial programs, an increase of $65.45 million over FY2000 levels.

7(a) LOANS

This is the SBA's leading loan guarantee program. The Administration proposal for appropriations for this program is based on an estimated program demand of $11.5 billion in loans, requiring $142.6 million in budget authority. The Committee believes this request is adequate. Recent SBA estimates of demand for 7(a) have proved accurate.

The Committee is more concerned over the increase in SBA subsidy cost estimates. Previous reports from GAO indicate that subsidy costs have been inflated. This has the potential to lead to the overcharging of small business borrowers. The current increase in 7(a) subsidy costs, despite improvements in purchases and recoveries, continues to raise concerns in the Committee. Rising subsidy costs will eliminate flexibility and discretion allowed the Congress in budgeting.

504 LOANS

Thanks to legislation passed in the 104th Congress, the 504 program has a zero subsidy rate; which means that the program requires no appropriations. This was accomplished through heavy fees that were placed on borrowers and lenders -- fees needed to offset a severe subsidy rate.

The Administration believes that the Section 504 loan program will not require appropriations for FY 2001, and will also be able to continue to lower fees to the program's borrowers. Improvements have appeared in the program's liquidation performance, the largest single factor in the subsidy rate equation and a source of significant concern to the Committee.

The Committee agrees that no appropriation will be needed for this program but is concerned that a report on recoveries within the program has not yet been completed.

SMALL BUSINESS INVESTMENT COMPANY PROGRAM

The Administration proposes an increased program level for both parts of the SBIC program. The Administration requests a $1.9 million increase in subsidy budget authority for the participating securities program. This will increase subsidy budget authority from $24.3 million to $26.2 million and increase the program level to $2 billion. The Committee supports the requested budget amount of $26.2 million.

The Administration also requests an increase in subsidy budget authority for the debenture program. In FY 2000 the debenture program operates at a zero subsidy rate requiring no appropriations and having to provide leverage up to $800 million dollars. The FY 2001 request for program level will be $500 million in debenture leverage, an amount higher than the estimated FY2000 demand of $450 million. However, this request comes with an increased cost in subsidy budget of $3.9 million because the subsidy rate has increased to 0.78%.

SBA has recently informed the Committee that this estimate is in error. Consequently, the request for subsidy budget authority is inflated. While the Committee supports the requested program level it has concerns over the change in subsidy costs. There have been no defaults in this program since 1992 due to improved management brought about by Congressional action. The Committee reserves judgment on the need for appropriations absent a full accounting. However, if the subsidy estimate remains at zero the Committee supports the full authorized level.

MICROLOAN PROGRAM

The SBA requests a more than 100% increase in funding for the microloan program for FY 2001. The program level will increase from $29 million to $60 million, and subsidy budget authority will increase from $2.5 million to $5.3 million. This increase reflects the SBA's desire to expand this program into all sectors of the country.

However, the Committee is troubled by the Administration' simultaneous support for the CDFI microloan program proposed for the Treasury Department. If the microloan program at SBA is, in fact, highly effective at assisting entrepreneurs in underserved areas, why is CDFI necessary? If the SBA program is ineffective then why is such a dramatic increase requested? The Committee believes this estimate may be valid, but not in light of the conflicting and duplicative CDFI program.

The Committee also wishes to express its desire that a portion of the requested increase be channeled to the guaranteed microloan program. SBA has continuously frustrated this program through lack of effort and regulations drafted in a fashion to discourage participation. This program offers an opportunity to expand the program at a reduced subsidy rate through established local lenders. This would not only provide a reduced cost to the taxpayer, but would provide microloan clients with exposure to traditional lending outlets.

(2) ASSISTANCE PROGRAMS

SUMMARY

The FY 2001 SBA budget submission proposes significant increases in spending on its non-credit business assistance programs. While these programs represent well-intentioned efforts to aid small business, there is a tendency to fragment rather than consolidate these efforts. In addition, areas of value appear to be targeted for cuts to support other initiatives that may be redundant.

Finally, the SBA proposes or increase several new, unauthorized programs at a cost of millions. The Committee has concerns over how these funds will be spent. New programs are being targeted for substantial expenditures while existing, proven programs are being dramatically cut. The Committee believes that non-credit assistance programs are valuable but must have duties and resources equitably allocated and justified prior to any increases.

DRUG -FREE WORKPLACE

The Administration requests no funding for this program. Further, it lists the program, fully authorized in Section 27(g) of the Small Business Act, as a Congressional Initiative. This, in spite of the fact that the Public Law authorizing this program passed the House of Representatives and Senate with overwhelming support and was enthusiastically signed by the President.

The Committee objects to this budget position which ignores concrete and significant efforts to improve the small business climate and workplace conditions.

MICROLOAN TECHNICAL ASSISTANCE

The Administration is requesting $45 million in technical assistance funds for the microloan program. These funds represent a hidden subsidy cost to the microloan program. While the reported subsidy rate of this program is relatively low, there is evidence that the technical assistance grants to the microlenders are, in fact, going to support operational expenses of the lenders rather than counseling. The Committee reserves judgment on the need for this additional funding. The Committee is particularly concerned that the need for this funding is duplicative of funding proposed in the PRIME/CDFI program, and vice versa.

ADVOCACY DATABASE

The Administration proposes $1.5 million for the Office Advocacy to support research and economic analysis. The Committee supports this proposal.

WOMEN'S BUSINESS COUNCIL

The Administration proposes increasing funding for the Women's Business Council from $400,000 to $1 million. The Committee supports the work of the Council but believes this request requires further justification.

WOMENS BUSINESS CENTERS

The Administration proposes increasing funding of this program to $12 million. The Committee supports this proposal and the excellent work performed by the centers.

BUSINESS INFORMATION CENTERS/USEACs

The Administration proposes increased funding for these programs. BICs will increase from $500,000 to $700,000. USEACs will increase from $3.1 million to $3.5 million. However, the agency fails to explain whether it intends to co-locate any of these centers with existing Small Business Development Centers. In fact, there are instances in several cities where these centers are located in separate sites within blocks of each other, rather than in a single central location.

The Committee supports the BIC and USEAC projects but requests that SBA to provide more substantial information on the activities of these sites and improve performance. Without such information the committee can not support the requested funding increases.

SMALL BUSINESS DEVELOPMENT CENTERS (SBDCs)

The Administration proposes $85 million in funding for the SBDC program. This proposal is a vast improvement over previous requests. The Administration also proposes $3 million to establish Native American SBDCs. The Committee supports this request.

HUBZONES

The Administration requests increased funding for this program from $3 million to $5 million. The Committee believes that, rather than pursuing staffing and funding increases, the SBA would better serve HUBZones businesses by implementing a simplified, on-line application process and outreach through established programs. Such an approach, combined with auditing support, would enable the program to reach far more small businesses than the 800 reached to date. This approach should be promoted in the final regulations for full implementation of this program.

ONE STOP CAPITAL SHOPS

The SBA FY2001 budget proposes a significant (210%) increase in funding for this program, from $3.1 million to $10 million. The SBA proposes to open the shops in each of the newly declared Empowerment Zones. The Committee notes that information regarding the use, services and merits of One Stop Capital Shops is limited. SBA reports that OSCS counseled 53,000 people last year and yet this resulted in only 530 loans. One percent is not an impressive return for a program designed to provide access to capital. The Committee is also concerned that the efforts of this program and Business Information Centers is duplicating efforts best left to other more established programs.

E-COMMERCE

The Administration requests $5 million to fund a new, unauthorized, program designed to teach small business about doing business over the Internet. While the Committee appreciates the SBA's belated interest in this area it is reluctant to fund a program of this cost without significant information regarding its application and availability.

BUSINESS-LINC

This is another unauthorized program. The Administration proposes increasing this program from an initial $1.5 million to $6.6 million. The Committee has received no information regarding the operation and organization of this program and, therefore, opposes any increased funding.

SBIR PHASE III

The Administration proposes $15 million in unauthorized grants for Phase III SBIR participants. The Committee wishes to make clear that the original intent of the SBIR program was to provide grants for ONLY the first two phases of SBIR participation. At that point the participant is expected to have developed outside sources of financing and support for Phase III.

If SBIR participants are experiencing difficulties in achieving Phase III financial or contractual support the Committee strongly suggests that the SBA marshal its significant other resources to support these businesses. The Committee strongly opposes this proposal.

NEW MARKET VENTURE CAPITAL COMPANIES

The Administration proposes $21 million in subsidy budget authority to support $150 million in lending by these NMVCCs. The Administration's FY 2001 budget also proposes $30 million in technical assistance grant funding for New Markets Venture Capital Companies. These NMVCCs will make SBIC loans in Low & Moderate Income areas. This means the Administration plans to spend $51 million in order to make $150 million in loans in LMI areas.

The Committee finds this questionable, particularly in light of the fact that regular SBICs made $800 million in investments in LMI areas last year - **without** this program. While the Committee supports the goal of increasing lending in LMI areas, it questions the high cost of this proposal. Also, the Committee has doubts that the SBA can implement this program quickly enough to justify any further appropriations. We believe the existing funding is sufficient absent a radical change in SBA efficiency.

(3) DISASTER ASSISTANCE

The President's FY 2001 SBA budget submission asks for authority for $871 million in disaster loans, representing the ten-year average of disaster loan needs. The budget requests $142.1 million in subsidy budget authority to support these loans.

The budget also requests administrative costs of $154 million. The SBA anticipates that $30 million in general S&E costs will derive from disaster loan administrative costs. The Committee believes that release and use of these administrative funds should track loan demand. Consequently, if SBA uses only 20% of the loan funds then they should need only 20% of the administrative funds transferred to general S&E.

The Committee supports this request and is pleased that the Administration has ceased manipulating disaster loan funding requests in order to shelter increases in other programs.

(4) SALARIES AND EXPENSES

For FY 2001 the Administration requests an increase in SBA non-disaster staffing and expenses. In FY1997- FY1999 full-time equivalents grew from the FY 1997 actual of 2,915 to an FY 1999 estimate of 3,133. This was an eight percent increase.

With more functions being outsourced, privatized and automated it is difficult to comprehend the need for staffing increases. SBA's staffing efforts need rethinking. If SBA is truly to become a cutting edge financial services agency with high-tech facilities it should require **fewer** employees due to increased productivity.

The FY 2000 budget submission showed an increase of 54 FTEs over FY 1998, with a request for a further 42 FTEs. In FY2001 there is no mention of FTEs in the budget submission. Why is this information missing?

The number of positions at the agency has apparently dropped from 3,123 in FY 1999 to 2,977 for the FY2000 estimate. For FY2001 the Administration requests 86 new SBA positions. The resulting positions number will still be 63 "slots" below FY1999. However, without the FTE count it is difficult to judge actual employment. 20 of these positions will serve the new NMI program.

The Committee also notes that the Administration has requested an additional $4 million for retraining and relocating employees and buying out employees. However, no details have been forthcoming regarding the nature of this retraining, or the destination of the relocated employees. This is the second year this has been proposed with little explanation of the retraining required.

(5) OFFICE OF INSPECTOR GENERAL

The Committee generally supports the proposed increase for the Office of Inspector General to $14.1 million. The Committee agrees that further vigilance will be required not only for the loan programs but also for the myriad grant-based assistance programs which require more scrutiny due to their less easily quantifiable parameters. Consequently, the Committee suggests that additional funding be allocated evenly between audit and investigative uses. The Committee also believes that funding is required for the Inspector General's efforts at stemming fraud in the disaster loan program.

CONCLUSION

The SBA continues to provide important services to the small business community. However, SBA's FY 2001 budget is, unfortunately, lacking in consistency. There is an increase in new unjustified programs at the expense of proven, useful programs. The unfortunate result is a budget document that is more of a wishlist than a serious or significant planning document.

Chairman Kasich, the Small Business Administration has a long history of real small business assistance. The Committee on Small Business looks forward to working with you to provide a more focused and realistic budget for the SBA of the future.

Sincerely,

Jim Talent

James M. Talent
Chairman